

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Department, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants described herein, interest on the Series AS Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. In the further opinion of Bond Counsel, interest on the Series AS Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series AS Bonds. (See “TAX MATTERS” herein).



\$645,795,000

**STATE OF CALIFORNIA DEPARTMENT OF WATER RESOURCES
CENTRAL VALLEY PROJECT WATER SYSTEM REVENUE BONDS
SERIES AS**

Dated: Date of Delivery**Due: December 1, as shown on Maturity Schedule**

The State of California Department of Water Resources (the “Department”) is issuing its \$645,795,000 Central Valley Project Water System Revenue Bonds, Series AS (the “Series AS Bonds”), for the purpose of providing funds to refund a portion of the Department’s outstanding Bonds and paying costs of issuance of the Series AS Bonds. In addition to the Series AS Bonds offered hereby, the Department expects to issue approximately \$140,000,000 of additional Bonds bearing interest at variable rates in 2014 for the purpose of providing funds to refund all or a portion of the Department’s then outstanding commercial paper notes, making a deposit to the Reserve Account and paying costs of the issuance of such Bonds. (See “PLAN OF REFUNDING.”)

The Series AS Bonds will be issued in fully registered form in denominations of \$5,000 or any integral multiple thereof, and will be delivered in book-entry form, without coupons, registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”). Purchasers of the Series AS Bonds will not receive physical certificates representing their interests in the Series AS Bonds. DTC will act as securities depository for the Series AS Bonds. The principal of and interest on the Series AS Bonds are payable directly to DTC by the Treasurer of the State of California. Interest is payable semiannually on June 1 and December 1 of each year, commencing on December 1, 2014. Upon receipt of payments of such principal and interest, DTC will in turn remit such principal and interest to the participants in DTC (as described herein) for subsequent disbursement to the beneficial owners of the Series AS Bonds. (See APPENDIX G – “DTC AND BOOK-ENTRY.”)

The Series AS Bonds are subject to redemption prior to maturity as described herein. (See “Description of the Series AS Bonds – Redemption.”)

Payment of the scheduled principal of and interest on the Series AS Bonds is secured by a pledge of Revenues under the Resolution.

THE SERIES AS BONDS ARE SPECIAL, LIMITED OBLIGATIONS OF THE STATE OF CALIFORNIA DEPARTMENT OF WATER RESOURCES. THE SERIES AS BONDS DO NOT CONSTITUTE A DEBT, LIABILITY, OR OBLIGATION OF THE STATE OF CALIFORNIA. NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF, OR PREMIUM, IF ANY, OR INTEREST ON THE SERIES AS BONDS.

**Maturity Schedule
(See Inside Cover)**

This cover page contains certain information for quick reference only. It is not intended to be a summary of the security or terms of the bond issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Series AS Bonds are offered when, as and if issued and received by the Underwriters subject to approval of validity by The Honorable Kamala D. Harris, the Attorney General of the State of California, and by Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Department, and certain other matters. Certain legal matters are also subject to the approval of Stradling, Yocca, Carlson & Rauth, counsel to the Underwriters. It is expected that the Series AS Bonds in book-entry form will be available for delivery to DTC on or about October 30, 2014.

**Honorable Bill Lockyer
Treasurer of the State of California**

MORGAN STANLEY

Goldman, Sachs & Co.
Hutchinson Shockey Erley & Co.
Mesirow Financial, Inc.
Prager & Co., LLC
Siebert Brandford Shank & Co., L.L.C.
Sutter Securities Incorporated
Wulff, Hansen & Co.

RAMIREZ & COMPANY

Great Pacific Securities
J.P. Morgan
Oppenheimer & Co., Inc.
RBC Capital Markets
SL Hare Capital, Inc.
US Bancorp

MATURITY SCHEDULE
relating to

\$645,795,000

**State of California Department of Water Resources
Central Valley Project Water System Revenue Bonds
Series AS
(Base CUSIP[†] 13066K)**

<u>Maturity Date</u> <u>(December 1)</u>	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Rate</u>	<u>Price</u>	<u>Yield</u>	<u>CUSIP[†]</u> <u>Suffix</u>
2018	\$ 2,565,000	2.00%	104.567%	0.860%	4S5
2018	12,395,000	4.00	112.580	0.860	5G0
2019	21,350,000	5.00	118.911	1.160	5H8
2020	3,775,000	4.00	114.739	1.460	4T3
2020	25,165,000	5.00	120.542	1.460	5J4
2021	32,575,000	5.00	121.717	1.730	4U0
2022	37,710,000	5.00	122.461	1.980	4V8
2023	54,365,000	5.00	123.686	2.120	4W6
2024	56,400,000	5.00	124.996	2.220	4X4
2025	57,220,000	5.00	123.975 ^c	2.320	4Y2
2026	72,025,000	5.00	122.864 ^c	2.430	4Z9
2027	81,950,000	5.00	121.964 ^c	2.520	5A3
2028	87,550,000	5.00	121.368 ^c	2.580	5B1
2029	94,395,000	5.00	120.677 ^c	2.650	5C9
2030	3,230,000	5.00	119.991 ^c	2.720	5D7
2031	1,525,000	5.00	119.406 ^c	2.780	5E5
2032	1,600,000	5.00	118.825 ^c	2.840	5F2

^c Priced to first optional call date of December 1, 2024, at a redemption price of par.

[†] Copyright 2014, American Bankers Association. CUSIP® is a registered trademark of the American Bankers Association. CUSIP data herein is provided by the CUSIP Service Bureau, operated by Standard & Poor's. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Services Bureau. CUSIP numbers have been assigned by an independent company not affiliated with the Department and are included solely for the convenience of the registered owners of the applicable Series AS Bonds. Neither the Department nor the Underwriters assume any responsibility for the accuracy of such numbers.

T H E C A L I F O R N I A

STATE
WATER
PROJECT



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No dealer, broker, salesperson or other person has been authorized to give or to make any representations other than those contained herein and, if given or made, such other information or representation must not be relied upon as having been authorized. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Series AS Bonds by a person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale. This Official Statement is not a contract with the purchasers of the Series AS Bonds. Statements contained in this Official Statement that involve estimates, projections, forecasts or matters of opinion, whether or not expressly so described herein, are intended to be solely as such and are not to be construed as representation of fact. The information set forth herein other than that provided by the Department, although obtained from sources which are believed to be reliable, is not guaranteed as to the accuracy or completeness.

This Official Statement, including any supplement or amendment hereto, is intended to be deposited with, and may be obtained from the Municipal Securities Rulemaking Board (“MSRB”) through the Electronic Municipal Market Access website of the MSRB, currently located at <http://emma.msrb.org>. The information contained on such website is not part of this Official Statement and is not incorporated herein.

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their respective responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

IN CONNECTION WITH THIS OFFERING THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS THAT MAY STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SERIES AS BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE SERIES AS BONDS TO CERTAIN DEALERS, INSTITUTIONAL INVESTORS AND OTHERS AT YIELDS HIGHER THAN THOSE STATED ON THE INSIDE FRONT COVER, AND THE PUBLIC OFFERING PRICES MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

The information and expression of opinions herein are subject to change without notice and neither delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the State of California, the Contractors or the Department since the date hereof.

This Official Statement is delivered for use in connection with the issuance, sale and delivery of the Series AS Bonds.

**CAUTIONARY STATEMENTS REGARDING
FORWARD-LOOKING STATEMENTS IN
THIS OFFICIAL STATEMENT**

Certain statements included or incorporated by reference in this Official Statement constitute forward-looking statements. Such statements generally are identifiable by the terminology used, such as “plan,” “expect,” “estimate,” “budget” or other similar words. Such forward-looking statements include but are not limited to certain statements contained in the information under the captions “Summary Statement,” “Introduction,” “Plan of Refunding,” “California State Water Project,” “Water System Projects,” “Estimated Capital Financing From Water System Revenue Bonds for Existing Water System Projects,” “Power Operations of the State Water Project,” “The Water Supply Contracts,” “The Contractors” and “Litigation.”

The achievement of certain results or other expectations contained in such forward-looking statements involves known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The Department does not plan to issue any updates or revisions to those forward-looking statements if or when its expectations or events, conditions or circumstances on which such statements are based occur or do not occur, except as described under the caption “CONTINUING DISCLOSURE” and in APPENDIX D.

THE SERIES AS BONDS WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXEMPTION CONTAINED IN SUCH ACT. THE SERIES AS BONDS HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE. THE SERIES AS BONDS HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY, AND THE FOREGOING AUTHORITIES HAVE NEITHER REVIEWED NOR CONFIRMED THE ACCURACY OF THIS DOCUMENT.

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SUMMARY STATEMENT

This Summary Statement is subject in all respects to the more complete information and definitions contained elsewhere in this Official Statement, including the Appendices attached hereto. Capitalized terms used in this Official Statement without definition have the respective meanings set forth in the Central Valley Project Water System Revenue Bonds, General Bond Resolution, No. DWR-WS-1 of the State of California Department of Water Resources, adopted as of July 1, 1986, and resolutions supplemental thereto, including the supplemental resolution authorizing the Series AS Bonds (the "Resolution").

The Department

The State of California Department of Water Resources is a department within the California Natural Resources Agency of the State of California. The Department is responsible for, among other things, the planning, construction and operation of the State Water Project, the operation of programs for the safety of dams, flood management, local assistance and subventions, other water-related matters and the operation of the Power Supply Program. Unless otherwise expressly noted, the term "Department," as used in this Official Statement, means the State of California Department of Water Resources solely in its capacity with respect to the State Water Project, and not in any other capacity mentioned herein.

Authorization of the Series AS Bonds

The Department will issue the Series AS Bonds pursuant to the provisions of Part 3 (commencing with Section 11100) of Division 6 of the Water Code of the State of California (referred to as the "Central Valley Project Act") and the Resolution.

The Series AS Bonds constitute a series of the Department's Central Valley Project Water System Revenue Bonds issued under the Resolution (all bonds issued under the Resolution, collectively, the "Bonds").

Purpose of the Series AS Bonds

The Series AS Bonds are being issued to (1) refund certain of the Department's outstanding Water System Revenue Bonds and (2) pay costs of issuance of the Series AS Bonds. (See "PLAN OF REFUNDING.")

Security for the Bonds; Limited Obligations

The payment of the scheduled principal of and interest on all Bonds, including the Series AS Bonds, is secured by a pledge of the Revenues under the Resolution, which are the portion of the receipts of the Department under the Water Supply Contracts resulting from the construction, acquisition or operation of Water System Projects (but only in the amounts required to meet the rate covenant of the Resolution), income from the investment of moneys held in the Revenue Fund pursuant to the Resolution and certain other moneys received by the Department under the Water Supply Contracts, which the Department in its discretion determines to be Revenues. The Department estimates that payments from The Metropolitan Water District of Southern California will account for approximately 41 percent of the Revenues to be derived from Water Supply Contract payments through the final maturity of the Bonds. However, that percentage may change over time. The balance of such Revenues will be receivable from the other Contractors. (See "SECURITY FOR THE BONDS" and "THE WATER SUPPLY CONTRACTS.")

THE SERIES AS BONDS ARE SPECIAL, LIMITED OBLIGATIONS OF THE STATE OF CALIFORNIA DEPARTMENT OF WATER RESOURCES. THE SERIES AS BONDS DO NOT CONSTITUTE A DEBT, LIABILITY, OR OBLIGATION OF THE STATE OF CALIFORNIA. NEITHER THE FAITH AND THE CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF, OR PREMIUM, IF ANY, OR INTEREST ON THE SERIES AS BONDS.

Rate Covenant

The Department has covenanted in the Resolution to charge and collect amounts under the Water Supply Contracts sufficient to return the costs of all Water System Projects without regard to whether or not the Department is able to construct, acquire or operate any such Water System Project and that Revenues receivable under all Water Supply Contracts in any year shall be the sum of 1.25 times the aggregate debt service payable from Revenues on all Bonds outstanding in such year, plus the amount estimated by the Department to be sufficient to provide for the costs of operation and maintenance of all Water System Projects, plus the amount, if any, required by a supplemental resolution authorizing a series of Bonds in order to deposit moneys in the Debt Service Reserve Account to meet the requirements of the Resolution for the issuance of additional Bonds. (See “SECURITY FOR THE BONDS – Rate Covenant.”)

Debt Service Reserve Account

The Resolution provides that on the issuance of each series of Bonds, provision must be made for placing moneys in the Debt Service Reserve Account, so that on the first interest payment date when interest on the Bonds of that series is to be paid from Revenues, there will be on deposit in the Debt Service Reserve Account an amount equal to, for any date of calculation, for all Series of Bonds outstanding for which interest is then payable in whole or in part from Revenues, one-half of the maximum Annual Debt Service for the then current Year or any Year after such date of calculation.

Upon the issuance of the Series AS Bonds and the application of the proceeds thereof as described in this Official Statement the amount on deposit in the Debt Service Reserve Account will be equal to or exceed the Reserve Account Requirement for the outstanding Bonds as of such issuance. (See APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION – Debt Service Reserve Account.”)

The State Water Project

The State Water Project is a complex of dams, water storage facilities, aqueducts, pumping stations and electric generation facilities, which have been constructed by the Department for the purposes of developing a water supply and conveying water to areas in need within the State of California (the “State”) and providing flood control, recreation, fish and wildlife enhancement, hydroelectric power and other benefits. All 647 miles of the initially planned aqueduct system have been completed. With the addition of the Grizzly Valley pipeline, the Thermalito Powerplant power canal and tail channel, and the extension of the East Branch aqueduct, the entire aqueduct system totals 705 miles. The 443-mile main stem California Aqueduct runs from a point near Stockton southward to a terminus in Riverside County. The dependable annual water supply available for delivery by the existing State Water Project will vary yearly depending on hydrologic conditions and regulatory mandates. (See “STATE WATER PROJECT WATER SUPPLY.”)

Under the Water Supply Contracts presently in effect, the Contractors may request from the State Water Project maximum annual delivery amounts totaling 4,172,786 acre-feet. Payments by the 29

participating local public agencies under the Water Supply Contracts provide for the operation, maintenance, planning and capital costs, including interest, of the State Water Project. (See “CALIFORNIA STATE WATER PROJECT,” “THE CONTRACTORS” and “THE WATER SUPPLY CONTRACTS.”)

Financing of the State Water Project

A large portion of the State Water Project has been financed from the issuance of \$1,582,400,000 in aggregate principal amount of State general obligation bonds, of which \$229,385,000 in aggregate principal amount are outstanding. The Department has also issued \$1,526,155,000 in aggregate principal amount of revenue bonds for certain power facilities of the State Water Project, of which \$57,430,000 in aggregate principal amount are outstanding. Such revenue bonds are secured by revenues of the Department other than those that are pledged to secure the Bonds and were and are issued under and secured by resolutions separate and apart from the Resolution authorizing and securing the Bonds. (See “FINANCIAL OPERATIONS – Financing of the State Water Project.”)

The Department has previously issued forty-four series of Bonds totaling \$7,987,050,000 in aggregate principal amount, of which \$2,392,740,000 in aggregate principal amount are outstanding under the Resolution. The Series AS Bonds offered hereby are the forty-fifth series of Bonds to be issued pursuant to the Resolution and secured by the Revenues pledged under, and the funds and accounts established by, the Resolution. The Department may from time to time issue additional Bonds secured by a lien on Revenues under the Resolution equally and ratably with the payment of scheduled principal of and interest on the Series AS Bonds and the currently outstanding Bonds. (See “INTRODUCTION,” “PLAN OF REFUNDING,” “SECURITY FOR THE BONDS – Outstanding Bonds; Additional Bonds,” “FINANCIAL OPERATIONS – Outstanding Revenue Obligations of the Department for the State Water Project.”)

The Department has authorized the issuance of its Water Revenue Commercial Paper Notes, Series 1 (the “Notes”) in a principal amount outstanding at any one time not to exceed the lesser of \$150,000,000 or the principal amount of Notes supported by the credit agreement then in effect (currently \$139,668,367). Proceeds from the sale of Notes are used to finance Water System Projects prior to permanent financing from the sale of Bonds. The Department’s obligation to make debt service payments on the Notes is subordinate to its payment obligations with respect to the Bonds. The Department currently has approximately \$110,500,000 aggregate principal amount of Notes outstanding. (See “PLAN OF REFUNDING.”)

Additional Bonds

The Department may issue, under certain conditions, additional Bonds to provide funds for the cost of any Water System Project or for refunding purposes. Such additional Bonds will be on a parity with outstanding Bonds and secured by an equal lien on the Revenues under the Resolution.

In addition to the Series AS Bonds, the Department expects to issue approximately \$140,000,000 of additional Bonds in 2014 bearing interest at variable rates to (1) refund all or a portion of the Department’s then outstanding Notes, (2) fund a deposit to the Debt Service Reserve Account, (3) fund interest on a portion of such Bonds through December 1, 2015, and (4) pay costs of issuance of such Bonds. (See “PLAN OF REFUNDING,” “SECURITY FOR THE BONDS – Outstanding Bonds; Additional Bonds” and APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION – Issuance of Bonds.”)

The Contractors

The 29 Contractors are principally located in the San Francisco Bay Area, the Central Coast, the Central Valley and Southern California and their service areas encompass approximately 25 percent of the State's land area and approximately 71 percent of its population. Each Contractor has entered into a Water Supply Contract with the Department, acting on behalf of the State. Certain of the Contractors receive a major portion of their income from *ad valorem* taxes. The ability of Contractors to tax for general purposes and to appropriate tax revenue for general purposes is limited under California law. (See "THE WATER SUPPLY CONTRACTS" and "CERTAIN LIMITATIONS ON CONTRACTOR REVENUE SOURCES.")

The Water Supply Contracts

The Water Supply Contracts are to remain in effect for the longest of 75 years, December 31, 2035 or until all bonds issued to finance construction costs of State Water Project facilities have been repaid, whichever period is longest, subject to an election on the part of each Contractor to receive continued service after such longest period on certain specified continued terms and conditions and other reasonable and equitable terms mutually agreed by the Department and the Contractor. (See "THE WATER SUPPLY CONTRACTS – Contract Extension Negotiations.") As of the date of issuance of the Series AS Bonds, the final maturity of the Bonds to be outstanding upon the issuance of the Series AS Bonds will occur in 2035. Under its Water Supply Contract, each Contractor may request water deliveries from the State Water Project up to a maximum specified annual amount, and agrees to pay its allocated share of the costs of gathering, storing, conveying and delivering water. Generally, the Department's costs, including interest, of providing the facilities of the State Water Project, including the Water System Projects, are payable by the Contractors whether or not water is delivered. If a Contractor defaults under its Water Supply Contract, the Department may, upon six months' notice, suspend water deliveries to that Contractor. During such period, the Contractor remains obligated to make all payments required by the Water Supply Contract. If a Contractor fails or is unable to raise sufficient funds by other means to make Water Supply Contract payments, the Contractor is required by the Water Supply Contract to levy a tax or assessment sufficient for such purpose.

The Department and the various subsets of Contractors ("affected Contractors") have entered into an Off-Aqueduct Power Facilities Amendment, an East Branch Enlargement Amendment, a Water System Revenue Bond Amendment, a Coastal Branch Extension Amendment, an East Branch Extension Amendment and a South Bay Aqueduct Enlargement Amendment to the Water Supply Contracts for the purpose of financing certain of the Water System Projects. These amendments establish procedures to provide for the payment of construction costs financed with Bonds by establishing separate subcategories of charges to produce the revenues required to pay all of the annual financing costs, including coverage, of the Bonds allocable to such Water System Projects. If any affected Contractor defaults on payment under certain of such amendments other than the Coastal Branch Extension Amendment, the East Branch Extension Amendment and the South Bay Aqueduct Enlargement Amendment, the shortfall may be collected from non-defaulting affected Contractors, subject to certain limitations. (See "SECURITY FOR THE BONDS" and "THE WATER SUPPLY CONTRACTS.")

In December 1994, representatives of the Department and certain Contractors adopted a set of principles pursuant to which additional amendments to the Water Supply Contracts have since been negotiated (the "Monterey Amendment"). The Department has covenanted in the Resolution not to amend the Water Supply Contracts in any manner that would materially adversely affect the security for the Bonds, and the Department believes that the Monterey Amendment complies with that covenant. (See "WATER SUPPLY CONTRACT RELATED LITIGATION – Monterey Amendment Litigation," for a description of certain litigation and the implementation of the settlement thereof that could affect the

Monterey Amendment. See also “WATER SUPPLY CONTRACT RELATED LITIGATION – Claims Relating to the Use of Bond Proceeds to Pay Costs Allocable to Recreation and Fish and Wildlife Enhancement.”)

Continuing Disclosure

The Department will covenant for the benefit of the holders and beneficial owners of the Series AS Bonds to provide certain financial information and operating data relating to the Department not later than 270 days following the end of each Department fiscal year (the “Annual Report”), commencing with the report containing 2013-2014 Fiscal Year financial information and to provide notices of the occurrence of certain enumerated events (“Event Notices”). The specific nature of the information expected to be contained in the Annual Report or the Event Notices and certain other terms of this continuing disclosure obligation are set forth in APPENDIX D – “SUMMARY OF CONTINUING DISCLOSURE CERTIFICATE.” Within the past five years the Department has not failed to comply, in all material respects, with all previous similar undertakings under continuing disclosure certificates.

No Relationship to Power Supply Revenue Bonds

The Department’s Central Valley Project Water System Revenue Bonds are not secured by the same sources of repayment as, and otherwise bear no material relationship to, bonds issued by the Department to finance and refinance the State of California’s Power Supply Program (the “Power Supply Revenue Bonds”). **The State Water Project and the Power Supply Program are separate and distinct enterprises, and have separate and distinct sources and uses of funds. Revenues pledged to secure payment of the Bonds may not be used to pay the Power Supply Revenue Bonds or any other expenses of the Power Supply Program, and resources pledged to secure the payment of the Power Supply Revenue Bonds may not be used to pay the Bonds or any other expenses of the State Water Project.**

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**STATE OF CALIFORNIA
DEPARTMENT OF WATER RESOURCES
OFFICIAL STATEMENT**

Relating to its

\$645,795,000

**Central Valley Project
Water System Revenue Bonds,
Series AS**

INTRODUCTION

This Official Statement is furnished by the State of California Department of Water Resources, in its capacity as operator of the State Water Project (the "Department"), for the purpose of setting forth information concerning its Central Valley Project Water System Revenue Bonds (the "Bonds" or the "Water System Revenue Bonds"), particularly the \$645,795,000 Central Valley Project Water System Revenue Bonds, Series AS (the "Series AS Bonds").

The Department will issue the Series AS Bonds pursuant to the provisions of Part 3 (commencing with Section 11100) of Division 6 of the Water Code of the State of California (referred to as the Central Valley Project Act and herein referred to as the "CVP Act") and the Central Valley Project Water System Revenue Bonds, General Bond Resolution, No. DWR-WS-1 of the Department, adopted as of July 1, 1986, and resolutions supplemental thereto, including the supplemental resolution authorizing the Series AS Bonds (such resolutions being herein, except as the context otherwise indicates, collectively called the "Resolution"). All capitalized terms used in this Official Statement and not defined herein have the same meanings as in the Resolution. (See APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION.")

This Official Statement also contains certain information with respect to the California State Water Project, the projects financed with the Bonds (the "Water System Projects") and the contracts for a supply of water from the State Water Project (the "Water Supply Contracts") between the Department on behalf of the State of California and 29 California public agencies (the "Contractors"). Contractor payments for water pursuant to the Water Supply Contracts are the principal component of the Revenues, as hereinafter defined, pledged for the payment of the interest on and the principal of the Series AS Bonds.

Purpose of the Series AS Bonds

The Series AS Bonds are being issued to (1) refund certain of the Department's outstanding Water System Revenue Bonds and (2) pay costs of issuance of the Series AS Bonds. (See "PLAN OF REFUNDING.")

PLAN OF REFUNDING

On the date of delivery of the Series AS Bonds, the Department will apply a portion of the proceeds of the Series AS Bonds to provide for the defeasance of all or a portion of the outstanding Bonds of Series AE, Series AF, Series AG, Series AH, Series AJ, Series AK and Series AN (the “Series AS Refunded Bonds”) as set forth below. The following table sets forth certain pertinent information with respect to the Series AS Refunded Bonds:

Bonds to be Refunded by the Series AS Bonds

Revenue Bond Series	Year of Issuance	Outstanding Principal Amount	Principal Amount to be Refunded	Interest Rate	Maturity Date	Redemption Date	Redemption Price
AE	2008	\$ 2,840,000	\$ 2,570,000	3.700%	12/1/2018	6/1/2018	100%
AE	2008	18,995,000	13,360,000	5.000	12/1/2018	6/1/2018	100
AE	2008	22,890,000	16,700,000	5.000	12/1/2019	6/1/2018	100
AE	2008	31,175,000	24,205,000	5.000	12/1/2020	6/1/2018	100
AE	2008	29,560,000	25,360,000	5.000	12/1/2021	6/1/2018	100
AE	2008	28,610,000	26,675,000	5.000	12/1/2022	6/1/2018	100
AE	2008	10,700,000	10,180,000	4.250	12/1/2023	6/1/2018	100
AE	2008	17,895,000	17,875,000	5.000	12/1/2023	6/1/2018	100
AE	2008	29,975,000	29,410,000	5.000	12/1/2024	6/1/2018	100
AE	2008	31,520,000	30,920,000	5.000	12/1/2025	6/1/2018	100
AE	2008	48,665,000	47,025,000	5.000	12/1/2026	6/1/2018	100
AE	2008	58,060,000	55,885,000	5.000	12/1/2027	6/1/2018	100
AE	2008	60,875,000	58,595,000	5.000	12/1/2028	6/1/2018	100
AE	2008	5,100,000	4,765,000	4.500	12/1/2029	6/1/2018	100
AE	2008	58,435,000	56,400,000	5.000	12/1/2029	6/1/2018	100
AF	2009	5,095,000	2,960,000	4.000	12/1/2019	12/1/2018	100
AF	2009	5,760,000	3,335,000	5.000	12/1/2019	12/1/2018	100
AF	2009	1,520,000	880,000	4.000	12/1/2020	12/1/2018	100
AF	2009	9,800,000	5,685,000	5.000	12/1/2020	12/1/2018	100
AF	2009	4,005,000	2,325,000	4.000	12/1/2021	12/1/2018	100
AF	2009	7,840,000	4,545,000	5.000	12/1/2021	12/1/2018	100
AF	2009	710,000	285,000	4.125	12/1/2022	12/1/2018	100
AF	2009	17,060,000	6,935,000	5.000	12/1/2022	12/1/2018	100
AF	2009	960,000	355,000	4.125	12/1/2023	12/1/2018	100
AF	2009	13,905,000	5,160,000	5.000	12/1/2023	12/1/2018	100
AF	2009	1,375,000	480,000	4.300	12/1/2024	12/1/2018	100
AF	2009	12,465,000	4,350,000	5.000	12/1/2024	12/1/2018	100
AF	2009	915,000	295,000	4.500	12/1/2025	12/1/2018	100
AF	2009	11,710,000	3,735,000	5.000	12/1/2025	12/1/2018	100
AF	2009	13,270,000	4,230,000	5.000	12/1/2026	12/1/2018	100
AF	2009	23,825,000	14,200,000	5.000	12/1/2028**	12/1/2018	100
AF	2009	2,650,000	1,540,000	4.750	12/1/2029	12/1/2018	100
AF	2009	14,965,000	8,705,000	5.000	12/1/2029	12/1/2018	100
AF	2009	4,880,000	4,880,000	5.000	12/1/2032**	12/1/2018	100
AG	2009	420,000	420,000	4.000	12/1/2020	12/1/2019	100
AG	2009	435,000	435,000	4.000	12/1/2021	12/1/2019	100
AG	2009	455,000	455,000	4.000	12/1/2022	12/1/2019	100
AG	2009	7,350,000	6,625,000	4.250	12/1/2023	12/1/2019	100
AG	2009	11,025,000	9,945,000	5.000	12/1/2023	12/1/2019	100
AG	2009	4,455,000	4,020,000	4.250	12/1/2024	12/1/2019	100
AG	2009	14,945,000	13,485,000	5.000	12/1/2024	12/1/2019	100
AG	2009	185,000	170,000	4.000	12/1/2025	12/1/2019	100

** Term Bond.

Revenue Bond Series	Year of Issuance	Outstanding Principal Amount	Principal Amount to be Refunded	Interest Rate	Maturity Date	Redemption Date	Redemption Price
AG	2009	20,290,000	18,325,000	5.000	12/1/2025	12/1/2019	100
AG	2009	20,095,000	18,165,000	5.000	12/1/2026	12/1/2019	100
AG	2009	22,915,000	20,730,000	5.000	12/1/2027	12/1/2019	100
AG	2009	24,105,000	21,825,000	5.000	12/1/2028	12/1/2019	100
AG	2009	32,365,000	25,880,000	5.000	12/1/2029	12/1/2019	100
AH	2010	5,735,000	1,850,000	4.500	12/1/2021	12/1/2020	100
AH	2010	1,685,000	540,000	5.000	12/1/2021	12/1/2020	100
AH	2010	3,755,000	1,215,000	4.750	12/1/2022	12/1/2020	100
AH	2010	4,000,000	1,285,000	5.000	12/1/2022	12/1/2020	100
AH	2010	5,820,000	2,620,000	5.000	12/1/2023	12/1/2020	100
AH	2010	4,870,000	2,760,000	5.000	12/1/2024	12/1/2020	100
AH	2010	3,880,000	2,895,000	5.000	12/1/2025	12/1/2020	100
AH	2010	4,080,000	3,035,000	5.000	12/1/2026	12/1/2020	100
AH	2010	4,275,000	3,185,000	5.250	12/1/2027	12/1/2020	100
AH	2010	4,505,000	3,355,000	5.250	12/1/2028	12/1/2020	100
AH	2010	4,740,000	3,525,000	5.250	12/1/2029	12/1/2020	100
AH	2010	1,850,000	1,850,000	5.250	12/1/2030	12/1/2020	100
AJ	2011	3,050,000	810,000	4.000	12/1/2022	12/1/2021	100
AJ	2011	6,595,000	1,715,000	5.000	12/1/2022	12/1/2021	100
AJ	2011	4,075,000	2,640,000	5.000	12/1/2023	12/1/2021	100
AJ	2011	5,880,000	2,780,000	5.000	12/1/2024	12/1/2021	100
AJ	2011	6,355,000	2,915,000	5.000	12/1/2025	12/1/2021	100
AJ	2011	3,095,000	3,070,000	5.000	12/1/2026	12/1/2021	100
AJ	2011	3,250,000	3,220,000	5.000	12/1/2027	12/1/2021	100
AK	2012	2,385,000	1,040,000	5.000	12/1/2022	6/1/2022	100
AK	2012	1,795,000	1,095,000	5.000	12/1/2023	6/1/2022	100
AK	2012	1,900,000	1,165,000	5.000	12/1/2024	6/1/2022	100
AK	2012	1,675,000	1,270,000	5.000	12/1/2026	6/1/2022	100
AN	2012	1,545,000	1,475,000	5.000	12/1/2023	12/1/2022	100
AN	2012	1,630,000	1,555,000	5.000	12/1/2024	12/1/2022	100
AN	2012	2,560,000	1,630,000	5.000	12/1/2025	12/1/2022	100
Total		\$862,030,000	\$689,780,000				

** Term Bond.

On the date of delivery of the Series AS Bonds, the Department will cause a portion of the proceeds of the Series AS Bonds, together with other available moneys, to be applied to the purchase of obligations of the United States of America or certain of its agencies or certain other securities permitted under the Resolution (the “Government Obligations”), which will be deposited, together with certain uninvested cash, if any, in an irrevocable trust (the “Series AS Escrow Account”) to be held by the Treasurer as security solely for the Series AS Refunded Bonds. The Government Obligations in the Series AS Escrow Account will mature at such times and in such amounts, and will bear interest payable at such times and in such amounts that, together with the uninvested cash on deposit in the Series AS Escrow Account, if any, sufficient moneys will be available to pay, when due or called for redemption, all principal of and interest on the Series AS Refunded Bonds. (See “VERIFICATION.”) Concurrently with the issuance of the Series AS Bonds, irrevocable instructions will be given to the Treasurer, as Trustee for the Series AS Refunded Bonds, to mail a timely notice of redemption with respect to the Series AS Refunded Bonds in accordance with the Escrow Agreement. Accordingly, upon issuance of the Series AS Bonds, adequate and complete provision will be made for the full and timely payment of the principal or redemption price of and interest on the Series AS Refunded Bonds when due, and the Series AS Refunded Bonds will be payable solely from the Government Obligations and uninvested cash, if any, on deposit in the Series AS Escrow Account. Once the deposit to the Series AS Escrow Accounts is made as described above, the Series AS Refunded Bonds will not be payable from Revenues as hereinafter defined nor from any other source of revenues.

In addition to the Series AS Bonds, the Department expects to issue approximately \$140,000,000 of additional Bonds in 2014 bearing interest at variable rates to refund all or a portion of the then outstanding Notes. The Notes expected to be refunded with such Bonds were, or will be, sold to finance capital costs of certain Water System Projects.

ESTIMATED APPLICATION OF SERIES AS BOND PROCEEDS

The following table sets forth the estimated application of the proceeds of the Series AS Bonds:

Deposit in Escrow Account to Refund Series AS Refunded Bonds ⁽¹⁾	\$784,991,027.93
Cost of Issuance of Series AS Bonds ⁽²⁾	<u>2,417,068.37</u>
Total Proceeds of the Series AS Bonds	<u>\$787,408,096.30</u>
Less Original Issue Premium	<u>141,613,096.30</u>
Principal Amount of Series AS Bonds	<u>\$645,795,000.00</u>

⁽¹⁾ Simultaneously with the delivery of the Series AS Bonds, \$1,071,571.25 will be released from the Debt Service Reserve Account and \$11,398,080.42 will be released from the Revenue Fund, representing amounts therein associated with the Series AS Refunded Bonds. These amounts will be deposited in the Series AS Escrow Account providing for the payment of the Series AS Refunded Bonds to and including their call date.

⁽²⁾ Includes underwriter’s discount, legal fees, financial advisory fees, printing expenses and other costs.

DESCRIPTION OF THE SERIES AS BONDS

General

The Series AS Bonds will be dated the date of delivery thereof, expected to be on or about October 30, 2014, will be issued in fully registered form without coupons, will be in denominations of \$5,000 principal amount or any integral multiple thereof, and will bear interest payable semiannually on June 1 and December 1 of each year, commencing on December 1, 2014 (each, an “interest payment date”). The Series AS Bonds will mature (subject to the right of prior redemption discussed below) on December 1 in each of the years and in the respective principal amounts, and will bear interest at the respective rates (calculated on the basis of a 360-day year composed of twelve 30-day months), as shown on the Maturity Schedule immediately following the cover page of this Official Statement.

Interest on the Series AS Bonds is payable to the person whose name appears on the Bond registration books of the Treasurer of the State of California (the “State Treasurer”) as the owner as of the close of business on the fifteenth day of the month immediately preceding an interest payment date, whether or not the day is a business day.

THE SERIES AS BONDS ARE SPECIAL, LIMITED OBLIGATIONS OF THE STATE OF CALIFORNIA DEPARTMENT OF WATER RESOURCES. THE SERIES AS BONDS DO NOT CONSTITUTE A DEBT, LIABILITY, OR OBLIGATION OF THE STATE OF CALIFORNIA. NEITHER THE FAITH AND THE CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF, OR PREMIUM, IF ANY, OR INTEREST ON THE SERIES AS BONDS.

Book-Entry Only

The Series AS Bonds will be issued as fully registered bonds and registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository for the Series AS Bonds. Purchasers will not receive certificates representing Series AS Bonds purchased by them. The State Treasurer will pay principal of and interest on the Series AS Bonds directly to

DTC. Upon receipt of payment of principal and interest DTC is obligated to remit such payments of principal and interest to the DTC Participants for subsequent disbursement to the beneficial owners of the Series AS Bonds. (See APPENDIX G – “DTC BOOK-ENTRY.”)

Redemption

Optional Redemption The Series AS Bonds maturing on or after December 1, 2025 are subject to redemption prior to their respective stated maturities, at the option of the Department from any source of available funds, as a whole, or in part by such maturities as the Department may designate (and by lot within any maturity), on any date on or after December 1, 2024, upon payment of a redemption price equal to the principal amount of the Series AS Bonds to be redeemed, plus accrued interest to the date fixed for redemption, without premium.

Selection of Bonds for Redemption. Whenever less than all the outstanding Bonds of any maturity of Series AS Bonds are to be redeemed on any one date, the State Treasurer shall select the Series AS Bonds of such maturity to be redeemed by lot in any manner the State Treasurer deems fair.

Notice of Redemption. So long as DTC is acting as securities depository for the Series AS Bonds, notice of redemption with respect to the Series AS Bonds will be given by mailing copies of such notice to DTC, not to the beneficial owners (as defined in APPENDIX G – “DTC AND BOOK-ENTRY” herein) of any Series AS Bonds designated for redemption, at least 20 days but not more than 60 days prior to the redemption date. The Resolution provides that if notice of redemption has been duly given and moneys for the payment of the redemption price of the Series AS Bonds called for redemption are held by the State Treasurer, then on the redemption date designated in such notice the Series AS Bonds so called for redemption will become due and payable, and from and after the redemption date, interest on the Series AS Bonds so called for redemption will cease to accrue and the holders of such Series AS Bonds will have no rights in respect thereof except to receive payment of the redemption price thereof.

The receipt of such a notice shall not be a condition precedent to such redemption and the failure to so receive any such notice shall not affect the validity of the proceedings for the redemption of Series AS Bonds for which notice of redemption was given.

Right to Cancel Notice of Redemption. Upon the written request of the Department, any notice of redemption may be cancelled by giving notice of such cancellation, in the same manner as for giving notices of redemption, at any time prior to the date fixed for redemption designated in such notice of redemption.

Effect of Redemption. If, on the date fixed for redemption, moneys equal to the redemption price of Series AS Bonds or portions thereof designated for redemption, together with interest accrued thereon to the date fixed for redemption, shall be held by the State Treasurer for such Bonds so as to be available for payment of such redemption price and interest on such date, and if notice of redemption shall have been mailed as provided in the Resolution, then such Bonds or portions thereof, whether or not presented for redemption, shall cease to be entitled to any benefit under the Resolution other than the right to receive payment of the redemption price together with accrued interest to the date fixed for redemption, no interest shall accrue on such Bonds or portions thereof after the date fixed for redemption, and, except as to the portion not designated for redemption of any Bond designated for redemption only in part, the redemption price of and accrued interest on such Bonds shall be payable only from the moneys held by the State Treasurer for such Bonds for that purpose.

Defeasance

The obligations of the Department and the pledge, lien, covenants and agreements of the Department made or provided for in the Resolution will be fully discharged and satisfied as to any Series AS Bond and such

Bond shall no longer be deemed to be outstanding thereunder if certain conditions set forth in the Resolution are satisfied. (See APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION – Discharge of Obligations Under the Resolution.”)

SECURITY FOR THE BONDS

Sources of Revenues

Under the Water Supply Contracts, the Contractors are required to pay to the Department amounts calculated by Department and to be sufficient to return to the Department its annual costs of the State Water Project allocated to water and power supply. The revenues pledged to the payment of the scheduled principal of and interest on all Bonds (the “Revenues”) are the portion of the receipts of the Department under the Water Supply Contracts resulting from the construction, acquisition or operation of Water System Projects (but only in the amounts required to meet the rate covenant of the Resolution), income from the investment of moneys held in the Revenue Fund pursuant to the Resolution and certain other moneys received by the Department under the Water Supply Contracts, which the Department in its discretion determines to be Revenues. Revenues do not include any other income or receipts resulting from the construction, acquisition or operation of a Water System Project other than the income and receipts specified in the immediately preceding sentence. Revenues from facilities constructed or acquired with the proceeds of CVP Act revenue bonds, including the Bonds, are not subject to the provisions of the Burns-Porter Act pledging other Water Supply Contract revenues to the payment of State general obligation bonds issued under the Burns-Porter Act. (See “FINANCIAL OPERATIONS – Allocation of State Water Project Revenues.”)

Under the Resolution, the Department is required to charge the Contractors amounts under the Water Supply Contracts sufficient to repay the costs of all Water System Projects, whether or not the Department is able to construct or operate the Water System Projects or to produce, make available or deliver water from the Water System Projects. The terms of the Water Supply Contracts provide for such charges. The Resolution requires that the Revenues receivable in each year, after deduction of the costs of operation and maintenance (excluding depreciation but including appropriate amounts for operating and replacement reserves) of the Water System Projects for such year (the “Water System Operating Expenses”) shall be at least equal to the sum of 1.25 times the debt service payable from Revenues on all Bonds outstanding in such year and the amount, if any, required by a supplemental resolution authorizing a series of Bonds in order to deposit moneys in the debt service reserve account established under the Resolution (the “Debt Service Reserve Account”) to meet the requirements of the Resolution for the issuance of additional Bonds. Amounts received in excess of operation, maintenance and debt service needs are held by the Department and refunded to Contractors approximately one year following receipt. Under the CVP Act, the payment of debt service has priority over the payment of operating expenses. Under current law, the charges of the Department under the Water Supply Contracts are not subject to regulation by any state or federal regulatory authority. (See “THE WATER SUPPLY CONTRACTS – Amendments Providing Certain Revenues to Pay Water System Revenue Bonds.”)

The Department estimates that upon issuance of the Series AS Bonds, payments from The Metropolitan Water District of Southern California (“Metropolitan”) will account for approximately 41 percent of the Revenues to be derived from Water Supply Contract payments. (See “THE CONTRACTORS – Selected Contractor Financial Information.”) However, that percentage may change over time.

Pledge of Revenues

The principal of, and premium, if any, and interest on the Bonds are payable from and secured by a lien upon and pledge of the Revenues. The Bonds are also payable from Bond proceeds and other available funds (except amounts, if any, in any Rebate Account) to the extent provided in the Resolution.

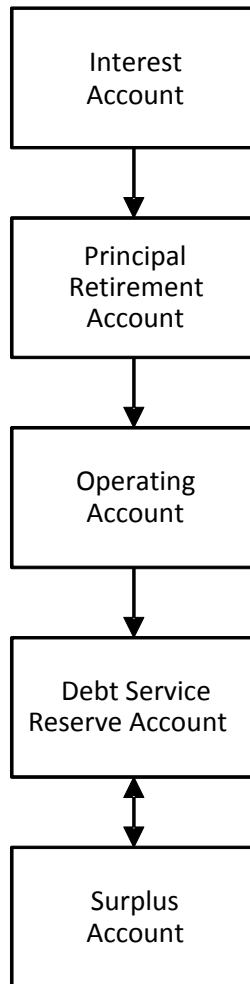
THE SERIES AS BONDS ARE SPECIAL, LIMITED OBLIGATIONS OF THE DEPARTMENT. THE SERIES AS BONDS DO NOT CONSTITUTE A DEBT, LIABILITY, OR OBLIGATION OF THE STATE OF CALIFORNIA. NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF, OR PREMIUM, IF ANY, OR INTEREST ON THE SERIES AS BONDS.

Flow of Funds

The portion of each Contractor’s payments under its Water Supply Contract attributable to the Water System Projects will be deposited in the Revenue Fund.

The diagram below illustrates the priority of allocations to various accounts within the Revenue Fund. (See APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION – Disposition of Revenues.”)

Priority of Allocation of Revenues



Moneys in the Debt Service Reserve Account may be used only to make up any deficiency in the Interest Account or Principal Retirement Account, in that priority.

Moneys in the Surplus Account are available for any lawful purpose, including transfer to funds not subject to the pledge of the Resolution.

Rate Covenant

The Department has covenanted in the Resolution to charge and collect amounts under the Water Supply Contracts sufficient to return the costs of all Water System Projects without regard to whether or not the Department is able to construct, acquire or operate any such Water System Project and that Revenues receivable under all Water Supply Contracts in any year shall be the sum of 1.25 times the aggregate debt service payable from Revenues on all Bonds outstanding in such year, plus the amount estimated by the Department to be sufficient to provide for the costs of operation and maintenance of all Water System Projects, plus the amount, if any, required by a supplemental resolution authorizing a series of Bonds in order to deposit moneys in the Debt Service Reserve Account to meet requirements of the Resolution for the issuance of additional Bonds. Amounts received in excess of operation, maintenance and debt service needs are held by the Department and refunded to Contractors approximately one year following receipt. The manner in which charges under the Water Supply Contracts are established and collected is described under “THE WATER SUPPLY CONTRACTS – Basic Contract – Water Charges” and “– Payment of Water Charges.”

Debt Service Reserve Account

The Resolution provides that on the issuance of each series of Bonds, provision must be made for placing moneys in the Debt Service Reserve Account, so that on the first interest payment date when interest on the Bonds of that series is to be paid from Revenues, there will be on deposit in the Debt Service Reserve Account an amount equal to, for any date of calculation, for all Series of Bonds outstanding for which interest is then payable in whole or in part from Revenues, one-half of the maximum Annual Debt Service for the then current Year or any Year after such date of calculation.

Upon the issuance of the Series AS Bonds the amount on deposit in the Debt Service Reserve Account will be equal to or exceed the Reserve Account Requirement for the outstanding Bonds as of such issuance date. (See APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION – Debt Service Reserve Account.”)

Upon the issuance of the Series AS Bonds, the amount of the Reserve Account Requirement for the outstanding Bonds will be approximately \$114,888,174. The Department anticipates that approximately 52 percent of the amount held in the Debt Service Reserve Account on the date of issuance of the Series AS Bonds will be invested in the State Treasurer’s Pooled Money Investment Account, with the balance invested directly in U.S. Government securities. (See “THE DEPARTMENT – Investments of Department Moneys.”) This percentage may change. (See APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION – Debt Service Reserve Account.”)

Outstanding Bonds; Additional Bonds

Bonds in an aggregate principal amount of \$2,392,740,000 are currently Outstanding and all Outstanding Bonds (including any additional Bonds) are secured equally and ratably with the Series AS Bonds. (See “PLAN OF REFUNDING,” “FINANCIAL OPERATIONS – Outstanding Revenue Obligations of the Department for the State Water Project” and “– Estimated Annual Debt Service.”)

The Department may issue additional Bonds on a parity basis with outstanding Bonds to finance the costs allocated to any Water System Project, including the cost of planning, construction or acquisition, or to refund bonds if, among other things, the Department certifies that (a) after the issuance of such Bonds, estimated Revenues in each year will not be less than the sum of (i) 1.25 times debt service to be paid from Revenues, plus (ii) estimated Water System Operating Expenses, (b) the Debt Service Reserve Account established pursuant to the Resolution is projected to contain on the first interest payment date on which interest for such additional Bonds is payable from Revenues, an amount equal to the Reserve Account Requirement, and (c) the State Treasurer must have received evidence that the issuance of the additional Bonds will not result in the lowering

of any rating then assigned to any then outstanding Bonds by any nationally recognized rating agency. (See APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION – Issuance of Bonds.”)

Pursuant to Section 11731 and 11751 of the CVP Act, the Department may issue revenue bonds bearing interest at a rate not exceeding 12 percent per annum and may sell revenue bonds at a price of not less than 94 percent. If the Department determines that interest on revenue bonds will be subject to federal income taxation and to the extent permitted by applicable law, such bonds may bear interest at such rate or rates, and may be sold at such price or prices, as the Department may determine.

THE DEPARTMENT

Introduction

The Department is a department within the California Natural Resources Agency of the State and is responsible for the planning, construction and operation of the State Water Project. The Department is also responsible for, among other things, the operation of programs for the safety of dams, flood management, local assistance and subventions and other water-related matters, and the operation of the Power Supply Program. The Department was established in 1956 by an act of the State Legislature that combined the functions of the Water Project Authority and certain responsibilities of the Department of Public Works’ former Division of Water Resources. At present, the Department employs approximately 3,065 full-time staff throughout the State.

Management

The Director of Water Resources oversees the Department’s activities, with the assistance of a Chief Deputy Director and five Deputy Directors. The Director and Chief Deputy Director are appointed by the Governor and report to the Governor through the Secretary of the California Natural Resources Agency. Biographical information for the management officials of the Department currently responsible for the State Water Project is as follows.

Mark W. Cowin has served as Director of the Department since February 2010. He has worked for the Department for over 30 years. Prior to his appointment as Director, Mr. Cowin served as Deputy Director of Integrated Water Management for the Department. In previous assignments with the Department Mr. Cowin served for five years as Chief of the Department’s Division of Planning and Local Assistance and as an Assistant Director for the CALFED Bay-Delta Program.

Laura King Moon was appointed Chief Deputy Director of the Department in September 2013. Ms. Moon is responsible for many of the Department’s administrative and water management policy issues. Prior to her appointment as Chief Deputy Director, she served as the Department’s project manager for the Bay Delta Conservation Plan since 2011. Prior to joining the Department Ms. Moon was an assistant general manager at State Water Contractors, a non-profit association consisting of 27 of the Contractors, from 2000 to 2011. She has also worked for two water agencies, as a special assistant to the regional director at the U.S. Bureau of Reclamation and as a senior staff scientist at the Natural Resources Defense Council.

Carl A. Torgersen was appointed Deputy Director for the State Water Project in April 2012, after serving as Acting Deputy Director for the State Water Project since September 2011. Mr. Torgersen is responsible for directing the activities of the Division of Engineering, Division of Operations and Maintenance, the State Water Project Analysis Office, the State Water Project Power and Risk Office, and the Hydropower License Planning and Compliance Office. Prior to this assignment, he was Chief of the Division of Operations and Maintenance since 2006. He has worked for the Department for more than 30 years. He is a licensed Professional Mechanical Engineer.

Cathy Crothers has served as Chief Counsel of the Department since April 2011, and was Acting Chief Counsel of the Department since May 2010. She oversees a staff of 40 attorneys working on the Department’s

varied and complex legal issues. She joined the Department in 1990 and prior to serving as Acting Chief Counsel she served as the Assistant Chief Counsel responsible for water rights, environmental compliance, energy planning, and local project financing since 2007.

Perla Netto-Brown has served as the Chief of the Division of Fiscal Services since May 2000 and as such is the chief financial officer of the Department. She joined the Department in 1986 and has served in various accounting positions in the Division of Fiscal Services prior to her appointment as Chief of the Division of Fiscal Services. Prior to joining the Department, Ms. Netto-Brown was an auditor with the California Auditor General.

Fund Accounting

The Department's operations with respect to the State Water Project are accounted for and conducted under special funds established by the California Water Code, principally the State Water Resources Development Bond Fund, the Central Valley Project Construction Fund (the "Construction Fund") and the Central Valley Project Revenue Fund (the "Revenue Fund"). The Department's operations with respect to the State Water Project are separate and apart from the Department's operations that are primarily funded by State General Fund appropriations and from the Department's Power Supply Program. (See "FINANCIAL OPERATIONS – Allocation of State Water Project Revenues.")

Employee Relations

The Ralph C. Dills Act, enacted in 1977, provides that State employees have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. However, once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent the bargaining unit employees. The Department has approximately 3,065 full-time employees of whom approximately 2,184 are represented in 10 of the 21 statewide bargaining units adopted by the Public Employment Relations Board ("PERB") for collective bargaining purposes. The remainder of the Department's employees are not covered by collective bargaining agreements because of their managerial, supervisory or confidential status.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreements are reached, to prepare a memoranda of understanding and present them to the Legislature for approval. In cases where the parties are unable to reach agreement, either party may request the PERB to appoint a mediator to assist them in reconciling a dispute.

Ten bargaining units represent employees of the Department. Currently, two of the ten memoranda of understanding (each an "MOU" and collectively, the "MOUs") in effect with respect to these bargaining units have expired. If an MOU expires without a successor MOU in place, as provided by State law the current MOU remains in effect until the successor MOU or an extension of the current MOU is negotiated and approved by the respective bargaining unit and the Legislature. The remaining eight MOUs have been renegotiated with effective dates through either July 1, 2015 or July 1, 2016.

In June of 2013 the California Department of Human Resources, the Department and the International Union of Operating Engineers reached an agreement which included, among other things, significant salary increases for the Department's trades and craft employees working on the State Water Project. This agreement will help address the Department's longstanding issues with recruitment and retention of qualified personnel critical to the operation and maintenance of the State Water Project. These issues have led to the Department being short staffed with respect to operation and maintenance of the State Water Project in recent years.

Pension Obligations

State departments and agencies, including the Department, participate in the California Public Employees' Retirement System ("PERS"), an agent multiple-employer pension system that provides a contributory defined-benefit pension for substantially all State employees. PERS has unfunded liabilities in the tens of billions of dollars. The Department is required to contribute the actuarially determined remaining amounts necessary to fund benefits for its employees, using actuarial methods and assumptions adopted by the PERS Board of Administration. For the years ended June 30, 2014 and June 30, 2013, the allocable share of annual pension contributions paid by the Department with respect to the State Water Project were approximately \$35.0 million and \$28.0 million, respectively. The level of future required annual pension contributions by the Department depends on a variety of factors, including changes in policy by the PERS Board of Administration, future investment portfolio performance, actuarial assumptions and additional potential changes in retirement benefits. There can be no assurances that the Department's required annual contribution to PERS will not significantly increase.

Additional information concerning State Water Project pension obligations, including a description of the actuarial assumptions and methods used to determine required contributions, is set forth in Note 8 of the financial statements of the State Water Resources Development System appearing in APPENDIX B. Such information is reported in part on the basis of State Miscellaneous Category Tier I and Tier II employees, of which State Water Project employees represent only a portion. For the years ended June 30, 2013 and June 30, 2012, Department contributions with respect to the State Water Project represented approximately 1.3 percent of contributions for all of State Miscellaneous Category Tier I and Tier II.

Post-employment Benefits Other Than Pensions

In addition to the pension benefits provided by the State, the State also provides post-retirement health care benefits, in accordance with California Government Code section 22760(g), to all employees who retire from the State on or after attaining certain age and length of service requirements. The post-retirement health care benefits are funded by the State General Fund on a pay-as-you-go basis. The State Water Project allocated required contributions made for post-retirement health care benefits were \$19.9 million for the year ended June 30, 2014. The accrued unfunded obligation amount was \$36.3 million, totaling \$36.2 million in recognized expenses for retiree's health care benefits for the year ended June 30, 2014 as compared to \$34.7 million for the year ended June 30, 2013. Additional information concerning State Water Project post-employment benefits other than pension obligations is set forth in Note 9 of the financial statements of the State Water Resources Development System appearing in APPENDIX B.

Investments of Department Moneys

The Department uses the State's Centralized Treasury System. Moneys on deposit in the State's Centralized Treasury System are invested by the State Treasurer in the Pooled Money Investment Account (the "PMIA"). As of August 31, 2014, the PMIA held approximately \$35.1 billion of State moneys, and approximately \$19.8 billion invested for about 2,531 local governmental entities through the Local Agency Investment Fund (the "LAIF"). The assets of the PMIA as of August 31, 2014 are shown in the following table:

Analysis of the Pooled Money Investment Account Portfolio

Type of Security	Amount (in thousands)	Percent of Total ⁽¹⁾
U.S. Treasury Bills and Notes	\$32,302,476	58.88%
Federal Agency Debentures.....	2,386,296	4.36
Certificates of Deposit.....	8,500,015	15.49
Bank Notes	300,000	0.55
Federal Agency Discount Notes	1,419,400	2.59
Time Deposits.....	5,000,240	9.11
GNMAs	0	0.00
Commercial Paper	3,708,839	6.76
FHLMC/REMICs	114,523	0.21
AB 55 Loans.....	334,670	0.61
Loans per Government Code.....	644,300	1.17
Other (International Bank for Reconstruction and Development Bonds)	149,917	0.27
Total	\$54,860,676	100.00%

⁽¹⁾ May not sum due to rounding.

Source: State of California, Office of the State Treasurer.

The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy that sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the Pooled Money Investment Board (consisting of the State Treasurer, the State Controller and the Director of Finance). The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The PMIA is not now invested, nor has it ever been invested, in structured investment vehicles or collateralized debt obligations. The PMIA Portfolio performance and the PMIA's holdings are displayed quarterly on the State Treasurer's website and may be accessed under PMIB Quarterly Reports. The PMIA does not currently invest in auction rate securities.

The State Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the total amount in the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash management date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of August 31, 2014 was 233 days.

As of August 31, 2014, the Department had approximately \$591,321,000 invested in the PMIA. The moneys consist of Contractor payments to the Department, which are invested on a short-term basis until they are expended for their designated purpose, replacement reserves, construction funds and debt service reserves.

CALIFORNIA STATE WATER PROJECT

Introduction

The State Water Project is one of the largest water supply projects undertaken in the history of water development and encompasses a complex of dams, reservoirs, pumping plants, powerplants, aqueducts and pipelines owned and operated by the State. The Department is responsible for the planning, construction and operation of the State Water Project. After a construction program that commenced in 1957, the project is now providing water to all 29 Contractors. Under the Water Supply Contracts presently in effect, the Contractors may request from the State Water Project maximum annual delivery amounts totaling 4,172,786 acre-feet. (See "THE WATER SUPPLY CONTRACTS.") An acre-foot is the amount of water that will cover one acre of land to a depth of one foot, and is equivalent to 325,900 gallons. However, the amount of water that may be made available for delivery by the State Water Project in any year will depend on various factors, and the Water Supply Contracts provide for reductions in water deliveries if the total amount available for delivery is insufficient to satisfy all Contractor requests. (See "STATE WATER PROJECT WATER SUPPLY.")

More than two-thirds of California's natural water supply originates in the northern third of the State, but more than three-quarters of the demand for water is in the southern two-thirds, which includes the San Francisco Bay area, the San Joaquin Valley, the central California coast and Southern California. The State Water Project was developed in order to deliver water to areas of need throughout the State for domestic, industrial and agricultural purposes, as well as to provide flood control, recreation, fish and wildlife enhancement, hydroelectric power and other benefits.

The State Water Project includes aqueducts, dams and reservoirs, pumping plants, hydroelectric generating facilities and other power plants. The State Water Project does not include any water treatment facilities or any desalination or other facilities for the production of water.

Portions of the State Water Project system consist of facilities developed and used jointly with the federal Central Valley Project operated by the U.S. Bureau of Reclamation (the "Bureau"). In addition, both projects have primary sources of water north of the delta formed by the confluence of the Sacramento and San Joaquin Rivers (the "Delta"), transport water across the Delta, and draw water from the southern edge of the Delta. The federal Central Valley Project, like the State Water Project, provides water for irrigation in the Central Valley, urban water supply, water quality, flood control, power, recreation, and fish and wildlife enhancement. Costs for the jointly developed facilities are shared, with approximately 55 percent being paid by the State and 45 percent being paid by the federal government. In 1986, the Department and the Bureau entered into a Coordinated Operation Agreement (the "COA") under which the State Water Project and the federal Central Valley Project coordinate operations, including releases from upstream reservoirs and pumping from the Delta. The COA permits increased operational efficiency for both projects, ensures that each project receives an equitable share of available surplus water, and provides for sharing responsibilities in meeting certain Delta water quality standards.

Aqueduct System; Pumping Facilities

All 647 miles of the initially planned aqueduct system have been completed. With the addition of the Grizzly Valley pipeline, the Thermalito Powerplant power canal and tail channel, and the extension of the East Branch aqueduct, the entire aqueduct system totals 705 miles. The main stem of the aqueduct system, the California Aqueduct, is 443 miles in length and transports water from the Delta through the Central Valley of California, over the Tehachapi Mountains and then into Southern California. Major branch aqueducts include the 28-mile North Bay Aqueduct north of the San Francisco Bay, the 45-mile South Bay Aqueduct in the southern San Francisco Bay area, the 116-mile Coastal Branch aqueduct from the southern San Joaquin Valley over the coastal mountains to the central California coast north of Los Angeles, the 32-mile West Branch aqueduct in Southern California and the 33-mile extension of the East Branch aqueduct in Southern California.

Aqueducts consist primarily of open concrete lined canals, siphons and underground pipelines. The main stem of the California Aqueduct has 381 miles of canals and siphons, 49 miles of pipelines or tunnels and 13 miles of channels and reservoirs. The branch aqueducts are mostly pipelines and tunnels rather than canals.

State Water Project facilities also include 20 pumping plants and stations, four pumping-generating plants, and five hydroelectric powerplants.

See the fold-out entitled “State Water Project Facilities” at the end of this Official Statement.

Storage Facilities

State Water Project facilities include 34 storage facilities of which 21 are primary reservoirs and lakes. Reservoirs are used to provide long term water storage, manage State Water Project water flows, provide recreation, and generate power.

See the fold-out entitled “State Water Project Facilities” at the end of this Official Statement.

The Department’s Division of Safety of Dams routinely inspects operating dams and may impose operating restrictions on dams and reservoirs that could adversely affect the operation of the State Water Project. One State Water Project dam, Perris Dam, is subject to a Division of Safety of Dams order. (See APPENDIX I – “WATER SYSTEM PROJECTS – Project Descriptions – *Perris Dam Remediation Program*.”)

Power Resources

State Water Project facilities include a number of power generation and transmission resources. (See “POWER OPERATIONS OF THE STATE WATER PROJECT.”)

Operational Control

The Department schedules and controls the operation of the State Water Project from a central operations center. This central operations center uses the communication and Supervisory Control and Data Acquisition (“SCADA”) systems to monitor and control the water and power movements in the aqueducts, pipelines and tunnels of the State Water Project in addition to the 29 pumping and generating plants of the State Water Project. Both the SCADA and communication systems are currently being upgraded and such upgrading is expected to be completed in December 2015. When complete the central operations center will continuously monitor and have remote control capability for all State Water Project facilities. Remote operations include start-up and shut down of pumping and generating units and opening or closing of gates and valves which control the flow of water throughout the State Water Project. However, under emergency or back-up operation mode, the operations of each field division are handled at the local field division level.

Seismic Considerations

State Water Project facilities are designed to withstand earthquakes without major damage, in accordance with Department’s Division of Safety of Dams criteria. Dams, for example, are designed to accommodate movement along their foundations and to resist earthquake forces on their embankments. Earthquake loads have been taken into consideration in the design of project facilities such as pumping plants and powerplants.

Major portions of the California Aqueduct are located parallel to and near the San Andreas Fault and other faults. All major faults are crossed either by canal at ground level or by pipeline at very shallow depths, to ease repair in case of damage from movement along a fault. The location of check structures on the canal allows for hydraulic isolation of any fault crossing repair.

Since the Loma Prieta earthquake of October 1989, eight earthquakes of Richter-scale magnitude of 6.5 or greater have occurred in or near California. Other than slight damage caused by the 6.7 Richter-scale magnitude Northridge earthquake of January 1994, no known damage to the State Water Project has been caused by an earthquake. Under the Water Supply Contracts, the Contractors are required to continue making all payments to the Department when due despite any interruption in water supply due to an earthquake.

A major seismic event causing damage to State Water Project facilities could disrupt the operation of the State Water Project or require significant unexpected capital expenditures. Central Valley and Delta levees could also be impacted by such an event. (See “STATE WATER PROJECT WATER SUPPLY – Central Valley and Delta Levees.”)

Self-Insurance; Financing of Emergency Repairs

The State does not maintain commercial insurance for the State Water Project nor does it maintain a funded insurance reserve. However, the Department maintains a replacement reserve, currently in the approximate amount of \$29.95 million, which it uses to replace certain equipment periodically. The Department is authorized to cause the issuance of notes, payable from available revenues or federal reimbursements under the National Disaster Act, for the purpose of providing funds for emergency repairs to power projects or the State Water Project necessitated by natural disasters, provided that certain conditions can be met.

Security Efforts; Emergency Preparedness

Department operations staff and security personnel undertake security efforts to safeguard the infrastructure, key facilities, information technology systems, personnel and the water supply of the State Water Project. Security measures include restrictions on public access to recreational and other State Water Project facilities, monitoring of State Water Project facilities, aerial surveillance of the aqueduct system, a comprehensive security assessment and a State Water Project-wide security plan.

The Department coordinates its security efforts with the California Emergency Management Agency and various State and federal law enforcement agencies as a matter of routine security procedure, and coordinates with other water, health, environmental and public safety agencies as needed. In addition, the Department is a participant on various California Emergency Management Agency committees.

Although the Department has undertaken many emergency preparedness and security improvements, a terrorist attack or significant natural disaster could materially impair system operations and water deliveries.

Environmental Considerations

Projects undertaken by the Department are generally subject to the California Environmental Quality Act (“CEQA”) and certain projects involving the participation of the Bureau or other federal agencies are also subject to the National Environmental Policy Act of 1969, as amended (42 U.S.C. Section 4321).

Under CEQA, a project that may have a significant effect on the environment and is to be carried out or approved by a public agency must comply with a comprehensive environmental review process, including the preparation of an Environmental Impact Report (“EIR”). The EIR reflects not only an independent technical analysis of the project’s potential impacts, but also the comments of other agencies with some form of jurisdiction over the project and the comments of interested members of the public. Contents of the EIR include a detailed statement of the project’s significant environmental effects; any such effects that cannot be avoided if the project is implemented; mitigation measures proposed to minimize such effects; alternatives to the proposed project; the relationship between local and short-term uses and long-term productivity; any significant irreversible environmental changes that would result from the project; the project’s growth-inducing impacts;

and a brief statement setting forth the agency's reasons for determining that certain effects are not significant and hence do not require discussion in the EIR. Before approving a project the agency must make findings on whether or how it can mitigate the significant environmental effects of the project. If the agency requires mitigation, the agency must adopt a mitigation monitoring plan to determine whether the mitigation is carried out during project implementation. If the agency determines that the project itself will not have a significant effect on the environment, it may adopt a written statement (called a negative declaration) to that effect and need not prepare an EIR. After deciding to approve or carry out a project, either following the EIR process or after adopting a negative declaration, the agency must file notice of such determination. Any action or proceeding challenging the agency's determination must be brought within 30 days following the filing of such notice. Actions have been, and in the future may be, filed against the Department challenging the Department's compliance with CEQA, including the adequacy of the EIR or other environmental documents, for a particular project. If the action is successful, the particular project could be delayed, revised, suspended or canceled. CEQA also contains a number of exemptions, which the Department uses for its projects when appropriate.

As part of its regular planning and budgetary process, the Department gives careful attention to environmental considerations. All projects are evaluated under the Department's environmental impact review procedures, developed in compliance with federal and State laws and regulations.

STATE WATER PROJECT WATER SUPPLY

General

Under the Water Supply Contracts, the charges payable by the Contractors are generally computed to enable the Department to recover its costs, including debt service on the Bonds when due. Such charges will vary with the amount of water delivered only to the extent that the amount of water delivered has an effect on the variable operation and maintenance costs of the State Water Project. The Contractors' obligations to make payments in amounts sufficient to pay debt service on the Bonds is not conditioned on the amount of water delivered. (See "SECURITY FOR THE BONDS – Sources of Revenues" and "THE WATER SUPPLY CONTRACTS.") However, the Department is obligated under its Water Supply Contracts, subject to the availability of funds, to make all reasonable efforts, consistent with sound fiscal policies, reasonable construction schedules and proper operating procedures, to complete the project facilities necessary to make water deliveries at the time and in the amounts specified in the Water Supply Contracts. This section describes the historical water supply available for delivery by the State Water Project and certain factors that have had or may in the future have an effect on the availability of such water supply. The Department can give no assurances that future legislation or regulation in any of the areas discussed in this section will not affect State Water Project operations including, but not limited to, reductions in the water supply available to the State Water Project.

Annual Water Deliveries

The annual water supply available for delivery by the State Water Project will vary from year to year depending on many factors including hydrologic conditions. The Department's annual determination of the State Water Project's delivery capability is based on extensive and ongoing analyses of operational capability taking into account (i) storage levels at the beginning of the year, (ii) target storage levels at the end of the year, (iii) the actual amount of snow and rainfall that has occurred to date in the year and a conservative estimate of the amount of snow and rainfall that may occur over the remainder of the year, (iv) the operational capacity of State Water Project facilities, and (v) operational mandates for in-stream water requirements and environmental protection of the Delta as imposed by federal and state regulatory agencies. Using this procedure, the Department has been able to meet the following percentages of Contractor requests for each of the last ten years:

**Annual Water Deliveries of the State Water Project
as a Percentage of Contractor Requests**

Year	Percentage of Contractor Requests Delivered ⁽¹⁾
2004	65%
2005	90
2006	100
2007	60
2008	35
2009	40
2010	50
2011	80
2012	65
2013	35

⁽¹⁾ The annual water delivery for each calendar year is determined in the Spring of that year and based on hydrological conditions at the time of determination and other factors as described in the preceding paragraph. The Spring determination of annual water delivery for a given calendar year is evaluated throughout the winter and may be revised in response to hydrologic conditions.

The delivery of less than 100 percent of Contractor requests in nine of the ten years listed in the preceding table reflect the impact of one or more of the factors listed in the preceding paragraph affecting the Department’s annual determination of the State Water Project’s delivery capability in each such year.

According to the draft Technical Addendum to the State Water Project Delivery Reliability Report 2013, dated September 2013, the Department estimates that if annual precipitation conditions vary in the same manner as they have over the eighty-two year period of analysis (water years 1922-2003, a water year consists of twelve consecutive calendar months beginning with the month of October and is identified by the calendar year in which it ends), the State Water Project would be capable of delivering at least 2,100,000 acre-feet of water in approximately 75 percent of the water years, at least 2,700,000 acre-feet of water in approximately 50 percent of the water years, and at least 3,100,000 acre-feet of water in approximately 25 percent of the water years. Under the Water Supply Contracts presently in effect, the Contractors may request from the State Water Project maximum annual delivery amounts totaling 4,172,786 acre-feet. The maximum annual delivery amounts were established when the Water Supply Contracts were executed and delivered, prior to the final determination of the scope of the State Water Project.

2014 Drought Conditions

Water years 2012 and 2013 were dry statewide, especially in parts of the San Joaquin Valley and Southern California. Water year 2014 to the date of this Official Statement is a third dry year. On April 18, 2014, the Department announced a 5 percent allocation of estimated State Water Project water delivery to the Contractors for calendar year 2014.

On December 17, 2013, the Governor directed the Department, the State Water Resources Control Board (the “SWRCB”), the Department of Food and Agriculture, and the Office of Emergency Services to convene an interagency Drought Task Force to review expected water project allocations, the state of preparedness, and whether conditions warrant declaration of statewide drought. The Governor subsequently issued a drought proclamation of emergency on January 17, 2014. Measures in the proclamation included:

- State agencies, led by the Department, are to execute a statewide water conservation campaign to make all Californians aware of the drought and encourage personal actions to reduce water usage.
- The Department and the SWRCB are to expedite the processing of water transfers.
- The SWRCB is to immediately consider petitions for consolidation of places of use for the State Water Project and the federal Central Valley Project, which could streamline water transfers and exchanges between water users in their service areas.
- The SWRCB is to put water rights holders across the state on notice that they may be directed to cease or reduce water diversions based on water shortages.
- The SWRCB is to consider modifying water quality control plan rules that require the release of water from reservoirs so that water may be conserved in reservoirs to protect cold water supplies for salmon and maintain other water supplies.
- The California Department of Fish and Wildlife (formerly known as California Department of Fish and Game) (“DFW”) is to evaluate and manage the changing impacts of drought on threatened and endangered species and species of special concern, and develop contingency plans for State Wildlife Areas and Ecological Reserves to manage reduced water resources in the public interest.
- The Department is to take needed actions to protect water quality and water supply in the Delta, including installation of temporary barriers or temporary water supply connections as needed, and will coordinate with DFW to minimize impacts to affected aquatic species.

The Governor issued a second drought proclamation on April 25, 2014 that incorporated all of the previous proclamation directives, and added the following major points, among others:

- The Department and the SWRCB will expeditiously process requests to move water to areas of need, and consider changes to water rights permits to enable such movements of water.
- The SWRCB shall direct urban water suppliers that are not already implementing drought response plans to limit outdoor irrigation and other wasteful water practices.
- The Department will expedite the consideration and, where appropriate, implementation of pump-back delivery of water through the State Water Project on behalf of water districts.
- The SWRCB will adopt statewide general waste discharge requirements to facilitate the use of treated wastewater to reduce demand on potable water supplies.
- The Department and the SWRCB will provide assistance to public agencies or private water companies in establishing temporary water supply connections to mitigate effects of the drought.
- The SWRCB will adopt emergency regulations to prevent the waste, unreasonable use or unreasonable method of diversion of water, to promote water recycling or water conservation, and to require curtailment of diversions when water is not available under the diverter’s priority of right. (See “STATE WATER PROJECT WATER SUPPLY – State and Federal Regulations Affecting the State Water Project – *State Water Resources Control Board Curtailment of Certain Water Diversions.*”)

The respective obligations of the Contractors to make payments in amounts sufficient to pay debt service on the Bonds are not conditioned on the amount of water delivered. However, the Department is obligated under its Water Supply Contracts, subject to the availability of funds, to make all reasonable efforts, consistent with sound fiscal policies, reasonable construction schedules and proper operating procedures, to complete the project facilities necessary to make water deliveries at the time and in the amounts specified in the Water Supply Contracts. See “SECURITY FOR THE BONDS” and “THE WATER SUPPLY CONTRACTS.”)

State and Federal Regulations Affecting the State Water Project

The following subsections describe certain state and federal regulation of the State Water Project and related litigation that could impact the ability of the Department to deliver water to the Contractors. The respective obligations of the Contractors to make payments in amounts sufficient to pay debt service on the Bonds are not conditioned on the amount of water delivered. (See “SECURITY FOR THE BONDS – Source of Revenues” and “THE WATER SUPPLY CONTRACTS” and “STATE WATER PROJECT WATER SUPPLY–General.”)

Bay-Delta Water Rights and Water Quality Regulation. The State Water Project diverts unregulated flow, and rediverts water it has stored upstream and later released into the Feather River, from the Delta. The Delta is also the source of water for local agricultural, municipal and industrial needs, and, in addition, supports significant resident and anadromous fish and wildlife resources and important recreational uses of water. Both the State Water Project’s upstream reservoir operations and its Delta diversions can at times affect these other uses of Delta water directly, or indirectly, through impacts on Delta water quality.

The SWRCB is responsible for regulating the State Water Project (along with the federal Central Valley Project operated by the Bureau) under the SWRCB’s water quality and water rights authorities to protect the reasonable needs of all beneficial uses of Delta waters. In this regard, in 1978, the SWRCB adopted a Water Quality Control Plan for the Bay-Delta estuary which has been amended periodically in 1991, 1995 and most recently in 2006. The Water Quality Control Plan for the Bay-Delta estuary as amended through 2006 is referred to herein as the “2006 Plan”. The SWRCB is currently in the process of updating the Water Quality Control Plan. In March 2000, the SWRCB implemented the Water Quality Control Plan, as amended through 1995, through a water rights decision known as “D 1641.” D 1641 is still in effect and requires the State Water Project and the federal Central Valley Project to meet the Water Quality Control Plan’s objectives for maintaining water quality. In addition, D 1641 recognizes a settlement (known as the “Sacramento Valley Water Management Program”) among the Department, Bureau, export contractors and upstream Sacramento Valley water users under which the parties have agreed to develop additional supplies of water for local use, for Delta protection, and for State Water Project and federal Central Valley Project use. The Department and the Bureau are responsible for funding the preparation of a draft Environmental Impact Report/Environmental Impact Statement that is required before approving actions to implement the settlement. However, work on the environmental document is on hold pending discussions among the various parties regarding how to proceed.

In February 2006, the SWRCB ordered the Department and the Bureau to take corrective actions to address threatened violations of their respective water rights permits implementing the southern Delta summer water quality objective for agricultural uses. Under this action, the Department and Bureau were to provide a schedule to the SWRCB of the proposed construction and operation of permanent operable gates in the southern Delta to help improve water quality. Other requirements of the enforcement action addressed the extent of the obligations of the State Water Project and federal Central Valley Project to protect water quality in the southern Delta. In response to a lawsuit filed against the SWRCB by the Bureau, certain Contractors and certain federal water contractors, the SWRCB clarified the enforcement order and the parties to the lawsuit entered into a stipulation for dismissal without prejudice and a tolling agreement, which extends to April 30, 2016. In addition, a June 2009 federal biological opinion for salmon, steelhead trout and green sturgeon states that the

Department shall not implement the permanent operable gates because that project would adversely modify critical habitat. As a result, in January, 2010, the SWRCB issued an order that modified its February, 2006 enforcement order by, among other things, allowing the Department and the Bureau to defer the construction of the permanent operable gates and requiring the Department and the Bureau to conduct studies and consider other measures to address water quality in the southern Delta until the SWRCB issues a new water quality control plan and related water rights decision for the Delta.

In December 2007, the SWRCB adopted a resolution setting out a process for the review of beneficial uses in the Delta in response to scientific studies showing a decline in native species and in support of the current efforts of the Bay Delta Conservation Plan Steering Committee and Delta Vision Task Force to develop plans to improve the Delta ecosystem. (See “STATE WATER PROJECT WATER SUPPLY – Long Term Planning Efforts for the Delta,” “– *The Delta Vision*” and “– *Bay Delta Conservation Plan*.”) In accordance with the resolution, in July 2008 the SWRCB adopted the Strategic Workplan for Activities in the San Francisco Bay/Sacramento-San Joaquin Delta Estuary (the “Strategic Workplan”) that describes a number of activities the SWRCB and Regional Water Quality Control Boards intend to pursue to address the water supply and environmental situation in the Bay-Delta. The Strategic Workplan activities are responsive to priorities identified by the Delta Vision Task Force, build on existing processes, such as the Bay Delta Conservation Plan, and identify a wide range of flow-related and water quality actions to better protect the Bay-Delta. The Strategic Workplan includes plans to review and update the 2006 Plan and to review the Bay Delta Conservation Plan, water rights, and other requirements to protect fish and wildlife beneficial uses. In February 2009, in furtherance of the Strategic Workplan, the SWRCB began the process to review and update the southern Delta salinity and San Joaquin River flow objectives, and their program of implementation. As part of this process, the SWRCB prepared an environmental document to evaluate the effects of potential modifications to the southern Delta salinity and San Joaquin River flow objectives and is considering adopting related amendments to the 2006 Plan. The initial environmental document is being revised by the SWRCB and modifications are scheduled for public review in late 2014. In January 2012, also in furtherance of the Strategic Workplan, the SWRCB began the process to review and update the other aspects of the 2006 Plan, which will include an environmental review of the effects of any proposed changes to the 2006 Plan.

In September 2010, three environmental groups filed a lawsuit against the SWRCB and the Department in State court, challenging the Department’s operations in the Delta on a variety of theories, including alleged violations of the public trust doctrine, D 1641 and the State Constitutional provision regarding reasonable use of water. The complaint claims that these violations have led to the recent decline of certain Delta fish species. The plaintiffs are asking the Court to declare that the SWRCB and the Department have violated the provisions and doctrine cited in the complaint and to enjoin the Department from diverting water from the Delta while these alleged violations persist. This lawsuit is in the pre-trial stage.

In July 2011, an organization representing 27 Contractors filed a lawsuit against the SWRCB and the Central Valley Regional Water Quality Control Board challenging an amendment to the Sacramento-San Joaquin Delta Basin Plan, a regional water quality plan, regarding the control in the Delta of methylmercury, a chemical which can be harmful to fish. The amendment, among other things, assigns certain responsibilities jointly to the Department (with regard to both the State Water Project and the Department’s flood management programs), the Central Valley Flood Protection Board and the State Lands Commission to control methylmercury in the open waters of the Delta in two phases. Phase I, which lasts for up to nine years, emphasizes studies and pilot projects to control methylmercury and Phase II requires implementation of measures to achieve required methylmercury levels by 2030. The Department was named as a real party in interest in the lawsuit. The Contractors contend that since the State Water Project activities do not add or introduce methylmercury into the open waters of the Delta, there is no basis in law for assigning such responsibility to the Department in its capacity as operator of the State Water Project. In March 2013, the lawsuit was dismissed with the agreement of the parties that the plaintiffs may re-file the lawsuit in the future.

State Water Resources Control Board Curtailment of Certain Water Diversions. In May 2014, the SWRCB sent water diversion curtailment notices to all post-1914 appropriative water rights holders on the Sacramento River and San Joaquin River watersheds. The Department's Oroville Reservoir is within the scope of the notice, so the Department is also precluded from diverting surface water during the pendency of the curtailment. However, this curtailment does not affect diversion of previously stored water, including previously stored water in Oroville Reservoir. The Department also expects these curtailments to be lifted or modified once precipitation occurs in the upcoming Fall/Winter 2014 period. In addition, in July 2014 the SWRCB adopted emergency regulations giving it the power to order the production of information regarding diversions of stored water releases. The SWRCB held a workshop in September 2014 to discuss the requests and comments regarding obtaining information pursuant to these emergency regulations.

Federal Endangered Species Act: General. The Department joins the Bureau in consultations with the US Fish and Wildlife Service ("USFWS") and the National Oceanic and Atmospheric Administration-Fisheries ("NOAA") regarding the impacts to endangered fish species from the operations of the State Water Project and federal Central Valley Project. This process results in the issuance of biological opinions pursuant to the Endangered Species Act ("ESA"). These biological opinions update, extend, and consolidate prior opinions and authorize the incidental taking of the listed species of fish by the two projects. Biological opinions are generally valid until changed conditions or new listings of species would require re-initiation of consultation.

Federal Endangered Species Act: Delta Smelt. In December 2008, the USFWS issued a biological opinion for Delta smelt and related water projects operations ("2008 Biological Opinion"), which superseded a previously issued Delta smelt biological opinion. The issuance of the 2008 Biological Opinion is now the operation-criteria for the State Water Project and federal Central Valley Project. The 2008 Biological Opinion requires operational measures to protect Delta smelt and, in addition, includes a measure specifying certain water flow requirements in the Delta during the fall season in wet years. This fall measure requires the two water projects to control salinity incursion in the Delta through increased water releases from water storage and fewer water diversions during wet years.

In March 2009, two water agencies that receive water from the federal Central Valley Project and an organization representing 27 Contractors filed separate lawsuits in federal District Court against the USFWS challenging the 2008 Biological Opinion as being too restrictive regarding pumping water from the Delta. The Department has intervened as a plaintiff in these cases, which have been consolidated and are now called the "Delta Smelt Cases." In November 2009, the Court ruled in favor of plaintiffs on one issue, that the 2008 Biological Opinion requires compliance with the National Environmental Policy Act ("NEPA") and that the Bureau is the appropriate federal agency to prepare the environmental documentation. In addition, in December 2010, the Court issued a decision that remanded the 2008 Biological Opinion to the USFWS to explain its scientific conclusions that the Court found to be arbitrary. These items included river flow and water quality issues, which could cause additional pumping reductions and/or upstream reservoir water releases under certain conditions. Both the November 2009 and December 2010 Court decisions were appealed by parties on both sides of the lawsuits. In March 2014, the Ninth Circuit Court of Appeals issued an opinion, reversing in part and affirming in part the lower Court's decision. The Court of Appeals reversed the lower Court's decision and upheld the 2008 Biological Opinion, ruling that the scientific conclusions in the 2008 Biological Opinion were not arbitrary. The Court of Appeals affirmed the lower Court's determination that NEPA compliance is required and that the Bureau is the appropriate federal agency to prepare the environmental documentation. The Court of Appeals also denied the Department's, the Contractors' and the federal water contractors' petitions for rehearing by the full Ninth Circuit Court of Appeals. A public interest organization has filed a petition for writ of certiorari seeking review by the United States Supreme Court of the Court of Appeals decision. Certain Contractors and federal water contractors have also indicated their intent to file a petition requesting United States Supreme Court review of the Court of Appeals' decision.

Federal Endangered Species Act: Salmon, Steelhead Trout and Green Sturgeon. In June 2009, following consultation with the Department and Bureau, NOAAF issued a new salmon, steelhead trout and green sturgeon biological opinion (“2009 Biological Opinion”), which superseded a previously issued biological opinion for these fish species. The 2009 Biological Opinion imposes restrictions on the Department’s pumping and operational activities in the Delta based upon the level of flows from the San Joaquin River and the presence of salmon and steelhead trout in the vicinity of the Delta pumping plant.

Six separate lawsuits were filed in federal District Court against NOAAF challenging the 2009 Biological Opinion as being too restrictive on the grounds that the measures to protect the fish are not supported by the best available science. Contractors, federal water contractors and local water districts were among the plaintiffs filing the lawsuits. The Department intervened as a plaintiff in these cases which were consolidated. In May, 2010, the Court ruled in favor of plaintiffs’ motion for a preliminary injunction that sought to enjoin two operational constraints limiting Delta pumping in 2010. The Court enjoined the two constraints, which allowed an increase in Delta pumping during May and June 2010. The Court also ruled in favor of plaintiffs that the 2009 Biological Opinion requires compliance with the National Environmental Policy Act and that the Bureau is the appropriate federal agency to prepare the environmental documentation. In December 2011, the Court issued its judgment regarding plaintiffs’ and Department’s summary judgment motions which challenged the 2009 Biological Opinion. The Court, having found that the biological opinion was not adequately supported in certain respects, remanded the opinion back to NOAAF and ordered the agency to issue a new final biological opinion by February 2016. NOAAF is expected to issue a revised draft biological opinion as the next step in response to the Court’s order and the Bureau will conduct an environmental review under NEPA thereafter. In the meantime, the 2009 Biological Opinion remains in effect, although in January and February 2012 parties on both sides of the lawsuits appealed the Court’s decisions. A hearing on these appeals was held in September, 2014, however, no decision has yet been issued. There are also certain seasonal export restrictions in the 2009 Biological Opinion that become operative at various times from January through June each year, and therefore there may be a hearing or other proceeding regarding permissible interim operations during the period that NOAAF is redrafting the opinion and during the pendency of the appeals, although no such hearing or other proceeding is expected in 2014.

Federal Endangered Species Act: Longfin Smelt. In April 2012, the USFWS found that the longfin smelt warrants consideration for protection under the ESA, but that it is currently precluded from listing the species because of the need to address other higher priority species. As a result, the USFWS has added the longfin smelt to the list of candidates for ESA protection, where the status will be reviewed annually. In the meantime there will be no specific restrictions regarding the longfin smelt imposed under the ESA. The longfin smelt is listed as threatened under the California Endangered Species Act (“CESA”) and the Department is already taking actions to protect the longfin smelt consistent with the take permit the Department received from DFW. (See “STATE WATER PROJECT WATER SUPPLY – State and Federal Regulations Affecting the State Water Project – *State Endangered Species Act.*”)

State Endangered Species Act. To obtain the authority under the CESA to “take” Delta smelt and salmon, the Department requested a “consistency determination” from DFW for the 2008 Biological Opinion and for the 2009 Biological Opinion. In July 2009, DFW issued its determination that the 2008 Biological Opinion was consistent with CESA and in September 2009, that the 2009 Biological Opinion was consistent with CESA. In late 2009, various Contractors filed three lawsuits regarding DFW’s consistency determinations issued to the Department. These lawsuits challenge the need for the Department to obtain any authorization from DFW under CESA and challenge the consistency determinations as containing overly restrictive conditions pertaining to State Water Project operations in the Delta. The consistency determination cases have been stayed pending the outcome of lawsuits challenging the 2008 Biological Opinion and the 2009 Biological Opinion (See “STATE WATER PROJECT WATER SUPPLY – State and Federal Regulations Affecting the State Water Project – *Federal Endangered Species Act: Delta Smelt*” and “– *Federal Endangered Species Act: Salmon, Steelhead Trout and Green Sturgeon.*”)

In March 2009, the California Fish and Game Commission also formally listed the longfin smelt, which resides in the Delta, as a threatened species under CESA. The DFW has granted the Department an incidental “take” permit for longfin smelt under CESA, which will continue in effect through December 2018. The permit incorporates the 2008 Biological Opinion for Delta smelt as an element of the take permit for longfin smelt. As a result, under most conditions, when certain flow restrictions for the protection of Delta smelt are being implemented, the permit imposes no additional requirements for the protection of adult longfin smelt. However, under the permit, the presence of adult or larval longfin smelt at certain locations during certain times of the year could cause a reduction in State Water Project water deliveries.

Both the consistency determinations for Delta smelt and salmon and the incidental take permit for longfin smelt incorporate conditions from the federal Biological Opinions for Delta smelt and salmon. The Department monitors activities in the federal cases and works with DFW to assure that the Department retains CESA compliance for its State Water Project operations. (See “STATE WATER PROJECT WATER SUPPLY – State and Federal Regulations Affecting the State Water Project – *Federal Endangered Species Act: Delta Smelt*” and “– *Federal Endangered Species Act: Salmon, Steelhead Trout and Green Sturgeon.*”)

Long-Term Planning Efforts for the Delta

The activities and programs described in this section “Long-Term Planning Efforts for the Delta” build on prior activities and programs, including the CALFED Bay-Delta Program begun in 1995 with the participation of various State and federal agencies, as well as California’s environmental, urban and agricultural communities, to develop long-term, collectively-negotiated solutions to the environmental and water management issues concerning the Delta.

The Delta Vision. In 2006 Governor Arnold Schwarzenegger established a task force to develop a long-term sustainable vision for the Delta. The task force issued a Delta Vision strategic plan in November 2008 and an implementation report for the strategic plan in January 2009, which included specific recommendations to the Governor. Fundamental actions in the plan include developing a new system of dual water conveyance through and around the Delta, additional water storage projects, an emergency preparedness strategy and water conservation goals, restoring the ecosystem and establishing a Delta governance structure. The task force also created a non-profit organization, the Delta Vision Foundation, following the conclusion of their recommendations to the Governor. The new organization provides updates to the public on its view of the progress of the Delta Vision’s implementation.

Delta Stewardship Council and Related Legislation. The Delta Stewardship Council was created pursuant to the Delta Reform Act of 2009, part of a legislative package enacted in November 2009. The legislative package addressed California’s statewide water situation, with particular emphasis on the Delta. The package included an \$11.1 billion general obligation bond measure, which measure has been subsequently amended, including a reduction in the amount of bonds authorized to \$7.2 billion. This bond measure is to be presented to the voters in November 2014. See “STATE WATER PROJECT WATER SUPPLY – Statewide Water Considerations – *Sources of Funding for Water Related Improvements*” below. The Delta Stewardship Council is charged with developing and implementing a Delta Plan, which will include the BDCP (defined in the next paragraph) if the BDCP is approved as meeting ESA and CESA requirements. The Delta Protection Commission, which is a State commission with certain land use responsibilities in the Delta, was directed in the same legislation to prepare an economic sustainability plan for the Delta and to provide information and recommendations to the Delta Stewardship Council. In 2012, the Delta Protection Commission completed the economic sustainability plan and provided its recommendations to the Delta Stewardship Council. The Delta Stewardship Council adopted the Delta Plan, along with regulations to implement the policies of the plan, in May 2013. The Council also certified the final program EIR for the Delta Plan on that date. Starting in May 2013, a number of legal actions were filed by certain federal water contractors, Contractors, local water agencies and environmental groups challenging the Delta Plan, associated regulations and the program EIR. The

Sacramento-San Joaquin Delta Conservancy, which was also established through the legislative package, will be implementing ecosystem restoration activities in the Delta based on a strategic plan that it has adopted. In addition, the package included separate bills that address groundwater, water conservation and unauthorized Delta water diversions.

Bay Delta Conservation Plan. An approach, known as the Bay Delta Conservation Plan (“BDCP”), is being developed by the Department, the Bureau, DFW and federal fish and wildlife agencies, to promote the recovery of endangered, threatened and sensitive fish and wildlife species and their habitats in the Delta in a way that will also protect and restore water supplies and address water conveyance through the Delta. The BDCP is intended to establish long-term regulatory coverage for up to 50 years for the State Water Project and federal Central Valley Project through permits issued under section 10 of the ESA, known as a Habitat Conservation Plan.

A formal public review draft BDCP and related draft EIR/EIS were released in December 2013. The plan and environmental review include analysis of strategies and measures to promote and improve the overall ecological health of the Delta and the species that inhabit the Delta and the analysis of water conveyance options including conveyance through Delta channels or alternative conveyance, including a canal or tunnel. The public comment period for these draft documents closed in July 2014 and the submitted comments are being reviewed. In addition, in August 2014, the Department announced that a recirculated draft BDCP and draft EIR/EIS will be published in early 2015 and that the recirculated documents will include those portions of each document that warrant another public review prior to publication of final documents. The public will also have the opportunity to review the final documents prior to their adoption and any decisions about the proposed actions.

As part of the information gathering process for the BDCP, the Department sought permission to access Delta properties for the purposes of environmental surveys and geotechnical exploration. Beginning in 2008, the Department filed petitions in court to gain access to the property of owners who had not granted permission. In early 2011, the trial court allowed access for Department environmental surveys, but denied access for the geotechnical exploration, which includes drilling activities. The property owners appealed the order allowing environmental surveys on their property and the Department appealed the order denying access for geological exploration. In March 2014, the Court of Appeal affirmed the trial court’s order denying the Department entry to conduct the geological activities and reversed the order granting the Department entry to conduct the environmental surveys. The Court of Appeal, in a two to one opinion, ruled that the access the Department was seeking requires compliance with the “taking” provisions of the State Constitution and eminent domain law. The California Supreme Court has accepted the Department’s petition for review and will be holding a hearing and issuing the decision in this case.

In October 2010, a separate lawsuit was filed challenging the Department’s environmental compliance and seeking to enjoin certain of the Department’s geologic activities in the Delta. After holding a hearing on the merits, the trial court ruled in November 2011 in favor of the Department and rejected the plaintiffs’ challenge. As a result, the Department has continued to conduct geologic activities in water and on properties to which the Department has access.

In October 2010, the Department entered into an agreement with DFW to coordinate efforts regarding the Department’s expenditure of approximately \$188 million over ten years for certain habitat restoration activities. These activities are intended to satisfy State and federal ESA habitat restoration requirements, as well as to provide credit towards the restoration component for the proposed BDCP.

The costs of any conveyance system, if ultimately approved and constructed through the BDCP process, could be substantial. For example, Chapter 8 of the formal public review draft BDCP titled “Implementation Costs and Funding Sources” includes a preliminary estimate of the total cost of implementation of the BDCP over its initial 50-year term of \$24.75 billion (in undiscounted 2012 dollars). This estimate includes capital costs

of \$14.57 billion and operation and maintenance costs of \$1.46 billion over the 50 year term. The current draft also contains a description of potential funding sources available to pay the cost of implementation of the BDCP for the initial 50-year term, including an estimate that approximately 68% of the total program costs would be paid by the Contractors and the federal water contractors benefiting from the Central Valley Project. The draft BDCP can be found on the website of the California Natural Resources Agency. The information contained on such website is not part of this Official Statement and is not incorporated herein.

Whether and/or the extent to which the BDCP will be implemented, the final form of any implementation of the BDCP, the process and cost of any implementation, the scope and specifics of any conveyance system, the specific allocation of costs and the method of any financing are all still to be determined.

Central Valley and Delta Levees

General. Water delivered to Southern California through the State Water Project must traverse the Delta through channels protected by levees that are susceptible to major failures due to flood and seismic events. If a major levee failure were to occur in the Delta or on the Sacramento River flood control system, it could adversely affect the ability of the Department to deliver State Water Project water through the Delta. In the event of such a failure, the quality of the Delta's water could be compromised from an increase in salinity and other adverse water quality conditions caused by an influx of water from the San Francisco Bay and could result in curtailing pumping of State Water Project water from the Delta southward to the Central Valley and Southern California. After Governor Arnold Schwarzenegger declared an emergency in 2006 for California's Central Valley levee system, including the Delta and Sacramento River flood control systems, the Department and U.S. Army Corps of Engineers repaired over 100 critical erosion sites. The Department has continued to evaluate and, as necessary, take action to repair other sites. In 2006, California voters approved Proposition 1E (the Disaster Preparedness and Flood Prevention Bond Act of 2006) and Proposition 84 (the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006), which together provide funding through the issuance of general obligation bonds to improve the State's flood management programs and infrastructure, including levees in the Delta and levees and structures of the Sacramento River flood control system. The Water Resources Reform and Development Act of 2013, signed by the President in June 2014, authorizes the United States Corps of Engineers to continue to participate in levee improvements on the Sacramento River in the Sacramento area. The next steps will involve obtaining funding, designing and constructing the levee improvements. In addition, the Department, through the Delta Levees Special Flood Control Projects Program and Delta Levees Maintenance Subventions Program, has funded significant repairs and improvements to the Delta levee system. In December 2011, the Department, as required by statute with regard to its flood management responsibilities, completed a Central Valley Flood Protection Plan that analyzes flood risks and potential measures to address those risks in the Delta and in certain other areas of the California Central Valley. The Central Valley Flood Protection Board adopted the Central Valley Flood Protection Plan in June 2012.

Lawsuits Regarding 2004 Delta Levee Failure. Four lawsuits were filed to recover damages caused when a Delta levee failed and flooded the Upper Jones Tract and Lower Jones Tract in June 2004. Three of the lawsuits named as defendants a local Delta reclamation district, the State Reclamation Board and the Department. A cause of action in each of these three lawsuits alleged that the State Water Project's operations and activities in the Delta were a cause of the damage. All four lawsuits were consolidated for trial and after completion of the trial, the trial judge issued a decision in August 2012 in favor of the Department. In October 2012, the plaintiffs, with the exception of two insurance companies, appealed the decision. The hearing on the appeal has been set for October 6, 2014. The Department does not believe that an adverse court decision in any of these consolidated cases would have a material adverse impact on State Water Project finances or operations.

Statewide Water Considerations

Sources of Funding for Water Related Improvements. In 1992, Congress enacted the Central Valley Project Improvement Act (the “CVPIA”), which required, among other things, many environmental restoration studies and projects, the cost of which is to be shared by the federal government and the State. In 1994, the Department entered into a cost sharing agreement with DFW, the Bureau and the USFWS (the “Cost Sharing Agreement”) for those projects. The State’s cost share is approximately \$175 million and is funded by general fund appropriations, general obligation bond financing and other sources. The Department does not expect State Water Project funds to be used for such purpose.

In addition to the CVPIA, California voter-approved measures such as Proposition 13 (the Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Act, approved in 2000), Proposition 50 (the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002), Proposition 84 (the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006) and Proposition 1E (the Disaster Preparedness and Flood Prevention Bond Act of 2006) have or will require the State to undertake a variety of projects for environmental restoration, water use efficiency and conservation, water supply enhancement and reliability, ecosystem restoration, watershed protection, water conveyance, delta levee restoration and water storage planning and studies. These measures authorize the issuance of State general obligation bonds to fund such projects. In 2009, the California legislature enacted another general obligation bond measure to take effect upon approval of the voters titled the Safe, Clean, and Reliable Drinking Water Supply Act of 2010. The California legislature amended such act to, among other things, change the date on which the measure would be submitted to voters for approval to a date in November 2014 and, subsequently amended such act to among other things revise the name of the act to the Water Quality, Supply, and Infrastructure Improvement Act of 2014. If this measure is approved by the voters in its current form, it would authorize \$7.12 billion in general obligation bonds to fund various water projects and programs. These include projects and programs designed to address water quality, safety and reliability, ecosystem and watershed protection and restoration, respond to climate change, water security and drought preparedness, water recycling, groundwater sustainability, flood management and statewide water system operational improvements. Funds provided by this measure are not to be expended to pay the costs of the design, construction, operation, mitigation, or maintenance of Delta conveyance facilities.

Programmatic Considerations. To achieve additional capability of supplying State Water Project water to the Contractors on a dependable basis at levels of acceptable water quality, the Department is considering additional water facilities and additional programs for reservoir and ground water storage, wastewater reclamation, and conservation. Alternatives under consideration include (1) new reservoir storage north and south of the Sacramento-San Joaquin Delta, (2) Delta conveyance, (3) conjunctive operation with ground water storage in State Water Project service areas, (4) purchase of water from federal or local developments, and (5) construction of local water supply developments within State Water Project service areas.

Future Mandates Relating to the Delta. Water rights issues and environmental regulation with respect to the Delta have been an active area in recent decades. See “State and Federal Regulations Affecting the State Water Project” and “Long Term Planning Efforts for the Delta.”

Invasive Species. Zebra and quagga mussels are established in many regions of the United States. In 2007, quagga mussels were discovered in the lower Colorado River and rapidly spread through the Colorado River Aqueduct into water distribution systems and reservoirs in Southern California. An isolated population of zebra mussels is established in San Justo Reservoir in Central California. Quagga and zebra mussel populations are located within 16 miles of the State Water Project. The mussels can clog water intakes, trash racks and other protective screens. Once established, the mussels cannot be easily eradicated using current technologies. Mussel management will result in a significant increase in the cost of operation and maintenance of water delivery systems. In addition, there can also be adverse ecological impacts. To prevent the spread of the

mussels into the State Water Project, the Delta and other bodies of water and water systems, the Department has joined with DFW, as the lead agency, and other state and federal agencies on a number of activities. These include boat inspections, monitoring of water bodies and water systems and education of the public, especially boat owners and operators. In addition, the Department has developed a Rapid Response Plan, Vector Management Plan, and Long-term Mussel Management and Control Plan as mandated by the California Fish and Game Code.

Climate Change. Climate change is already impacting California's water resources. Rising temperatures are, for example, resulting in more precipitation falling as rain instead of snow, in turn reducing the Sierra snowpack. With respect to the State Water Project, climate change could affect the timing and amount of water supply available for delivery, flood risk, environmental protection requirements, hydropower generation, and recreational opportunities. The Department considers the potential impacts of climate change and greenhouse gas emissions in both its project-level and long-term planning. For instance, in May 2012, the Department adopted a Climate Action Plan, which covers all aspects of the Department, including the State Water Project. The impact of climate change on the State Water Project and the extent to which the Department will need to take additional actions to address the effects of climate change are uncertain.

POWER OPERATIONS OF THE STATE WATER PROJECT

The State Water Project is one of the largest consumers and suppliers of electric power in the western United States. This section describes the State Water Project's power-related activities. Revenues from the State Water Project's power related activities are not pledged to the payment of the Bonds.

The activities and responsibilities of the California Energy Resources Scheduling Division of the Department (the "CERS Division") in connection with the State's program of supplying electricity to retail customers are separate and distinct from the activities and responsibilities of the Department in connection with the State Water Project. This section describes the CERS Division's power supply activities and historical or recent events concerning those activities only to the extent they affect the State Water Project.

Historic Involvement of State Water Project in Power Markets

Since the commencement of the major facilities of the State Water Project in the 1960's, the Department has been an active participant in the power markets of California and the western United States. The Department currently owns and operates seven power facilities with a total generating capacity of approximately 1,600 MW and with total annual energy generation in recent years ranging between approximately 3,000 and 6,000 GWh. (See "POWER OPERATIONS OF THE STATE WATER PROJECT – Power Generation.") The Department also owns and operates 20 pumping plants and 3 pumping-generating plants with a total load, if all were operational simultaneously, of approximately 2,000 MW and total annual energy consumption in recent years ranging between 5,300 and 10,000 GWh. By way of comparison, the average load for all electricity users in California is approximately 30,000 MW and total 2011 consumption in California, according to the California Energy Commission, is approximately 273,000 GWh.

The pumping plants, which are the State Water Project's major power-consuming components, can be operated principally during the off-peak portion of the daily electricity consumption cycle due to their large pumping capacity. Similarly, the designed capacity of most of the Department's hydroelectric generation facilities permits those facilities to be operated at 100 percent of generation capacity during on-peak hours and generally held idle during off-peak hours. This flexibility in the scheduling of the Department's generation and load enables the Department to sell relatively high value power during on-peak hours and buy less expensive power during off-peak hours, or to do the functional equivalent by entering into contracts to deliver power on demand during on-peak hours in exchange for substantially larger amounts of power delivered to the Department during off-peak hours.

In addition to the seven power facilities it owns, the Department also has long-term contracts for the purchase of power from Pine Flat Powerplant, which is owned and operated by Kings River Conservation District, Lodi Energy Center, which is owned and operated by Northern California Power Agency, and five small hydroelectric powerplants, which are owned and operated by The Metropolitan Water District of Southern California.

Power Generation

The Department has provided for the financing, construction and operation of a variety of power projects including hydroelectric, geothermal and coal-fired electric generating facilities and facilities to transmit electric energy. The table below summarizes current megawatt hour generation, construction costs and completion date for the Department’s power projects.

	Capacity (MW)	Expected Annual Generation (MWh)	Construction Cost in Millions	Completion Date
Alamo Project Powerplant	17	114,000	\$ 49.4	1986
Castaic Powerplant.....	214	719,000 ^(a)	82.0	1978
Devil Canyon Powerplant	280	1,770,000	198.4	1993
Mojave Siphon Powerplant.....	29	96,000	65.6	1996
Hyatt-Thermalito Complex (Oroville).....	762	2,202,000	282.0	1987
William E. Warne Powerplant (Pyramid)	74	472,000	80.0	1983
Gianelli (San Luis) Pumping-Generating Plant.....	222	188,000 ^(a)	47.2	1967

^(a) State Water Project share.

See the fold out entitled “State Water Project Facilities” at the end of this Official Statement.

Power Sales and Purchases

Periodically, the Department enters into long-term and mid-term energy sales agreements and energy exchange agreements with municipal utilities, private utilities, and other entities that buy or sell energy in California and neighboring states. The Department also transacts with the California Independent System Operator (“CAISO”) in its markets for day-ahead and real-time energy purchases and sales. In addition, the Department sells ancillary services from its generating facilities to the CAISO and buys ancillary services from the CAISO to meet the requirements for its State Water Project pumping plants. These agreements and arrangements with utilities, entities that buy or sell energy, and the CAISO allow the State Water Project to manage its power operations. The table below provides the Department’s historical revenues from power sales and costs of power purchases on an annual basis over the past five calendar years.

Year	Costs of Power Purchases (in millions)	Revenues from Power Sales (in millions)
2009	\$162	\$110
2010	267	154
2011	271	110
2012	218	81
2013	240	102

Because the Department procures significant amounts of electric power for State Water Project operations in the short-term markets for power, it has exposure to volatility in the electric power market. This exposure is mitigated by the fact that the bulk of the State Water Project's power needs can be met through Department-owned generation, long term and mid-term power purchase contracts and energy exchange arrangements. (See "POWER OPERATIONS OF THE STATE WATER PROJECT – Historical Sources of Power for State Water Project Operations.") It is further mitigated by the fact that the majority of the State Water Project's power needs are during off-peak periods on the daily energy consumption cycle, when the demand for and the cost of energy are generally lower. (See "POWER OPERATIONS OF THE STATE WATER PROJECT – Historic Involvement of State Water Project in Power Markets.")

The cost of power for State Water Project operations is paid out of the California Water Resources Development Bond Fund. (See "FINANCIAL OPERATIONS – Allocation of State Water Project Revenues.") Power costs for State Water Project operations allocable to water supply to the Contractors are passed on to Contractors under the Water Supply Contracts through the variable operation cost component of the Transportation Charge. (See "THE WATER SUPPLY CONTRACTS – Basic Contract – *Water Charges*.") The Department's exposure to any volatility in short-term power costs is aggravated by the fact that the variable operation cost component of the Transportation Charge is paid on an estimated basis subject to "true up" approximately two years later. If the Department underestimates power costs in assessing the variable operation cost component, it will typically not recover the difference between actual and estimated costs for approximately two years. (See "THE WATER SUPPLY CONTRACTS – Basic Contract – *Payment of Water Charges*.") Under the Water Supply Contracts, however, the Department has the option under certain circumstances to revise its billings, and it has exercised that option in the past.

The Department regularly solicits energy purchase, sale and exchange proposals from electric utilities and energy supply companies to address the need for a reliable supply of its Water System Project energy requirements. In addition, the Department has entered into a Power Sales Agreement with Northern California Power Agency and other project participants, reflecting the Department's participation in the Lodi Energy Center to assist it in meeting its power needs. The Department completed an integrated resource plan in 2009 that identified additional strategies to meet its future power needs. (See "POWER OPERATIONS OF THE STATE WATER PROJECT – Lodi Energy Center.")

On balance, the Department does not expect the cost of power to have a material adverse effect on its ability to continue to operate and maintain the State Water Project or on the security for, or the Department's ability to repay, the Bonds. However, no assurance can be given that the Department will not experience disruptions in State Water Project operations due to future deterioration in the California energy markets.

Historical Sources of Power for State Water Project Operations

The historical sources of power for operating the State Water Project on a calendar year basis for the years 2009 through 2013 are set forth in the table below. The Department has satisfied its power load through its own resources, long-term purchase and exchange contracts and short-term and spot market purchases, as needed.

	Electrical Energy (millions of kilowatt hours)				
	2009	2010	2011	2012	2013
State Water Project Hydroelectric Plants					
Gianelli (San Luis)	56	87	74	143	86
Castaic	606	442	412	609	571
Devil Canyon.....	554	991	1,291	941	577
William E. Warne (Pyramid).....	280	266	240	355	346
Hyatt-Thermalito Complex (Oroville)	1,427	1,524	2,198	1,622	1,488
Alamo	55	79	105	30	25
Thermalito Diversion Dam.....	23	21	12	21	12
Mojave Siphon	30	60	82	58	34
Subtotal SWP Sources	<u>3,031</u>	<u>3,470</u>	<u>4,414</u>	<u>3,778</u>	<u>3,139</u>
State Water Project Thermal Plant (Reid Gardner Project) ^(a)	1,224	901	843	1,029	491
Power Purchases	3,300	4,031	3,604	2,320	2,825
Energy via Exchanges	106	0	0	0	0
Total Sources.....	<u>7,661</u>	<u>8,402</u>	<u>8,867</u>	<u>7,127</u>	<u>6,455</u>
Less Power Sales (Excess Sources)	2,223	1,814	1,192	533	967
Plus Net Transactions through CAISO	--	596	867	808	229
SWP Load.....	<u>5,438</u>	<u>7,184</u>	<u>8,583</u>	<u>7,402</u>	<u>5,717</u>

^(a) The Reid Gardner Power Plant is operated by NV Energy. The Participation Agreement between the Department and NV Energy for coal-fired energy from a portion of the Reid Gardner Power Plant terminated in 2013. The Department replaced a portion of the energy lost by termination of this agreement with energy provided to the Department from the Lodi Energy Center. (See "POWER OPERATIONS OF THE STATE WATER PROJECT – Lodi Energy Center.")

Power Transmission

State Water Project power transmission needs are presently served through transmission service contracts and transmission ownership.

Transmission Service Contracts. The Department obtains 78 percent of the High Voltage transmission service used by the State Water Project from the CAISO under a Scheduling Coordinator Agreement with the CAISO. Included in this transmission service is access to CAISO trading hubs. The Department also has a major transmission service contract with PG&E that provides 22 percent of the High Voltage transmission service used by the State Water Project.

The Comprehensive Agreement with PG&E, dated April 22, 1982 (the "PG&E Comprehensive Agreement"), provides firm non-interruptible High Voltage and Low Voltage interconnection and network transmission service in PG&E's Service Area throughout Northern and Central California. The PG&E Comprehensive Agreement expires on December 31, 2014. Upon termination of the PG&E Comprehensive Agreement, the Department will be using the California Independent System Operator's network transmission service to replace the firm network service previously provided under the PG&E Comprehensive Agreement.

The interconnection portion of the service previously provided under the PG&E Comprehensive Agreement to the Department will be provided under new contracts with PG&E, which are currently being negotiated.

The Department also has several transmission agreements with Edison that provide for the connection of State Water Project facilities in Edison's service area to the transmission grid.

Transmission Ownership. The Department also either solely or partially owns several transmission lines that interconnect State Water Project facilities with PG&E's transmission system. The following is a summary of the transmission lines owned by the Department:

The 10 mile Oroville Complex-Table Mountain 230 kilovolt line is solely owned by the Department. The triple-circuit line connects the Hyatt and Thermalito Powerplants to PG&E's Table Mountain substation.

The Castle Rock-Lakeville 38-mile 230 kilovolt double-circuit line is co-owned with PG&E and others. The Department owns a 165 megawatt entitlement in this line, but has leased 55 megawatts to other public utilities. The remaining 110 megawatt entitlement has been retained by the Department.

The one mile Pine Flat 230 kilovolt transmission line is solely owned by the Department. This transmission line emanates from the Pine Flat Powerplant and interconnects with PG&E's system.

The Department owns 75 percent of the 230 kilovolt double-circuit transmission line between Midway substation and Wheeler Ridge substation; the other 25 percent is owned by PG&E. The transmission line connects the Buena Vista, Wheeler Ridge and Wind Gap pumping plants to the PG&E Midway substation. Each pumping plant's tie line is solely owned by the Department.

Federal Energy Regulatory Commission Proceedings

A number of proceedings are pending before the Federal Energy Regulatory Commission ("FERC") relating to the Department as operator of the State Water Project. Some of these proceedings address requests from the CAISO, investor-owned utilities and others to increase or adjust rates or allocate responsibility for costs for transmission and other services provided to the Department and other entities in California. The Department is participating in these proceedings because the outcome of these proceedings has the potential to increase the Department's annual power costs. However, the Department does not believe that any increased charges arising from these proceedings will materially impact the Department's operations or ability to pay debt service on the Bonds. Any increased charges will be passed through to the Contractors under the Water Supply Contracts in the form of higher operating charges.

California Energy Crisis and Claims for Partial Energy Purchase Refunds

The California energy crisis of 2000-01 adversely impacted the financial condition of some energy market participants, including the Department as operator of the State Water Project. As a supplier of energy, the Department received increased market prices for energy sales in 2000 and in 2001. FERC proceedings were instituted to address power purchaser requests for partial refunds from sellers of energy and related services in 2000 and 2001, including the Department. However, in September 2005, the United States Ninth Circuit Court of Appeals ruled that FERC lacked jurisdiction under the Federal Power Act to order governmental entities, such as the Department, to provide refunds in these types of proceedings. As a result of this Ninth Circuit Court of Appeals' ruling, a group of California entities filed similar claims for partial energy purchase refunds with the California Victim Compensation and Government Claims Board against the governmental entity sellers, including the Department. The Claims Board denied the claim made against the Department, which would have allowed the claimants to file a lawsuit against the Department. Settlement discussions were thereafter conducted and on August 19, 2014, a settlement agreement was reached between the Department and the claimants, the

California Public Utilities Commission and the CERS Division (see POWER OPERATIONS OF THE STATE WATER PROJECT). Under the settlement, the Department paid \$7.2 million and assigned approximately \$19.6 million in receivables from the CAISO and the California Power Exchange Corporation to the claimants and other settling parties. In return, the claimants and other settling parties will withdraw, and release the Department from, all of their claims related to the 2000 and 2001 energy sales. The Department does not believe that the settlement will have a materially adverse effect on the ability of the Department to pay its obligations when due or its ability to operate and maintain the State Water Project.

Reid Gardner Termination, Groundwater Contamination Cleanup and Environmental Lawsuit

The Reid Gardner Project consisted of the Department's interest in a 260 megawatt coal-fired steam electric generating unit ("Unit 4") in Nevada constructed by NV Energy ("NVE"). The Department's ownership interest in the Reid Gardner Project terminated in 2013. (See APPENDIX I – "WATER SYSTEM PROJECTS – Project Descriptions – *Reid Gardner Project.*")

In February 2008, NVE entered into an Administrative Order on Consent with the Nevada Division of Environmental Protection, pursuant to which NVE agreed to undertake investigatory activities and remediate the soil and groundwater contamination attributable to the Reid Gardner Generating Station. NVE operates the Reid Gardner Generating Station, which houses four coal-fired generating units. Prior to termination of the Department's ownership interest in the Reid Gardner Project in 2013, the Department owned 67.8 percent and NVE owned 32.2 percent of Unit 4 as tenants in common. The Department also had a 29.2 percent share of the common facilities at the site. As a former co-owner of Unit 4, the Department has agreed to share the cost of NVE's investigatory and soil and groundwater remediation activities that are related to Unit 4's construction and operations from July 1979 through July 2013. These activities are projected to continue through at least 2023. However, the Department believes that its participation in these remediation activities will not have a material adverse impact on State Water Project finances or operations.

In August 2013, a Native American Tribe and an environmental organization filed a lawsuit against NVE and the Department in federal district court in Nevada claiming violations of the federal Resource Conservation and Recovery Act and the Clean Water Act related to operations of the Reid Gardner Generating Station, which includes the unit in which the Department had an ownership interest. The lawsuit asserts, among other things, violations for alleged contamination of soil, groundwater and surface water and discharge of pollutants into the nearby river. In March 2012, the same band of Native Americans in Nevada served a notice on NVE and the Department of intent to file a similar lawsuit under the federal Clean Air Act, but no such lawsuit has yet been filed. However, the Department believes that these lawsuits, if filed and if successful, would not have a material adverse impact on State Water Project finances or operations.

Oroville Facilities Relicensing Program

In January 2005, the Department filed its application with FERC for a new license for its Hyatt-Thermalito hydroelectric generation facilities, which are referred to by FERC as the Oroville Facilities (Project No. 2100) ("Oroville Facilities"). The existing FERC license, granted in 1957, expired on January 31, 2007. The Department's application requested a new 50-year license and was filed with a comprehensive settlement agreement for the relicensing of the Oroville Facilities (the "Settlement Agreement") with 51 stakeholders including federal, state and local agencies, and individuals. FERC issued an annual license effective February 1, 2007, with provisions for automatic annual renewals until a new long term license is issued. The Department has used a collaborative approach to relicensing (referred to as "Alternative Licensing Procedures") that involves working cooperatively with federal and State resource agencies, Indian tribes, local public agencies, non-governmental organizations and other interested parties to achieve consensus on the FERC license application and environmental documentation.

In March 2006, the Department and 51 settling parties signed the Settlement Agreement. The Settlement Agreement covers the protection, mitigation, and enhancement measures that will be implemented over the term of a new license to balance the Oroville Facilities operations with the environment and other project resources such as recreation, cultural, land use, and aesthetics. The Settlement Agreement has been submitted to FERC with the settling parties requesting FERC to adopt only the agreed-upon provisions as the terms and conditions of the new FERC license, so as not to jeopardize settlement. Other parties, that were not parties to the Settlement Agreement, have also intervened in the relicensing proceeding with various requests for additional conditions to be included in the new license. These parties include Butte and Plumas Counties, several Indian tribes, and other interest groups and individuals. The Department has responded in opposition to the inclusion of the proposed additional conditions.

FERC published its Final Environmental Impact Statement (“FEIS”) in May 2007, which completed the federal environmental documentation process. The FEIS included the majority of the Settlement Agreement terms that come under FERC jurisdiction. The Department issued the final EIR in July 2008. Butte and Plumas Counties filed lawsuits challenging the adequacy of the final EIR. After holding a hearing on the merits, the court issued its decision in favor of the Department in 2012. The county plaintiffs have appealed the court’s decision but a hearing date has not yet been set. Notwithstanding the lawsuits, in January 2010 the SWRCB, using the Final EIR, issued the required Clean Water Act Section 401 Water Quality Certification for the Oroville Facilities. FERC and the Department are awaiting the issuance of a final biological opinion for the project from the NOAAF. The Department expects that the new FERC license would be for a term of 30 to 50 years. In the meantime, FERC is expected to continue issuing annual licenses for the Oroville Facilities.

Lodi Energy Center

The Department and other participants entered into a Power Sales Agreement with the Northern California Power Agency (“NCPA”) in May 2010 to purchase a portion of the output of the Lodi Energy Center (“LEC”), which is a 280 megawatt natural gas-fired combined cycle power plant located in Lodi, California and which is owned, operated, and maintained by NCPA. The LEC began operation in November 2012. Under the Power Sales Agreement, the Department receives 33.5 percent of the output of the LEC and pays NCPA for a proportionate share of the construction, operation, and maintenance costs of the LEC. The Department uses its share of the LEC to meet State Water Project energy requirements, including replacing a portion of the energy previously provided by the Reid Gardner Project. (See APPENDIX I – “WATER SYSTEM PROJECTS – Project Descriptions – *Reid Gardner Project*.”)

Thermalito Powerplant Fire

On November 22, 2012, a major fire occurred at the Thermalito Powerplant, which is part of the Hyatt-Thermalito hydroelectric generation facilities located on the Feather River near Oroville. The fire caused substantial damage to the plant rendering the plant inoperable. Until the plant is repaired and placed back in service, the electrical generation from the Hyatt-Thermalito facilities will be reduced. The Thermalito Powerplant facility and generating units continue to be cleaned, decontaminated, and structurally repaired to provide for safe occupancy. The Department has considered the feasibility of repairing and reconstructing the plant and equipment and has determined to rebuild the plant. The Department does not believe that this event will have a material adverse impact on the Department’s ability to operate and maintain the State Water Project. The costs for rebuilding the Thermalito Powerplant will be financed with Bonds. (See APPENDIX I – “WATER SYSTEM PROJECTS – Project Descriptions – *Facilities Reconstruction and Improvement Project*.”)

No Relationship to Power Supply Revenue Bonds

In response to the California energy crisis of 2000-01, the Department created the separate CERS Division to perform its function as supplier of energy to retail customers under its Power Supply Program, and

to distinguish and keep that program separate and distinct from its power activities in connection with the State Water Project. The Department has issued Power Supply Revenue Bonds to finance and refinance a portion of the costs of the Power Supply Program. \$5.943 billion of Power Supply Revenue Bonds are currently outstanding.

The State Water Project and the Power Supply Program are separate and distinct enterprises, and have separate and distinct sources and uses of funds. None of the power generated by the State Water Project is being or will be sold to the Power Supply Program. Revenues pledged to secure payment of the Bonds may not be used to pay the Power Supply Revenue Bonds or any other expenses of the Power Supply Program, and resources pledged to secure the payment of the Power Supply Revenue Bonds may not be used to pay the Bonds or any other expenses of the State Water Project.

FINANCIAL OPERATIONS

Financing of the State Water Project

In addition to the revenue bond obligations described under “FINANCIAL OPERATIONS- Outstanding Revenue Obligations of the Department for the State Water Project” below, a large portion of the State Water Project has been financed by the sale of general obligation bonds of the State pursuant to the provisions of the Burns-Porter Act, which authorized the issuance of \$1,750,000,000 in aggregate principal amount of such bonds for the construction of the State Water Project. The Burns-Porter Act was adopted by the voters at the State’s general election of November 8, 1960. Of that authorization, \$1,582,400,000 in aggregate principal amount (including the entire amount available for construction of the initial components of the State Water Project) has been issued, of which \$229,385,000 in aggregate principal amount are outstanding. The unissued \$167,600,000 of the authorization is available only to provide funds for the construction of certain additional water conservation facilities.

Certain other moneys have been made available to the Department to pay the cost of construction of the State Water Project, including the proceeds of the sale of revenue bonds pursuant to the CVP Act (see “FINANCIAL OPERATIONS – Outstanding Revenue Obligations of the Department for the State Water Project”), a portion of the moneys from State offshore oil royalties, other State appropriations, the PMIA Loan (defined below), and federal reimbursements for project costs allocated to flood control.

After the issuance of the Series AS Bonds, the Department anticipates issuing approximately \$1,417.1 million of additional Bonds to finance completion of existing Water System Projects. (See APPENDIX I – “WATER SYSTEM PROJECT – Capital Expenditures for Water System Projects.”) In addition, the Department could issue additional Bonds to finance all or a portion of the settlement agreement costs of FERC relicensing of its power, water storage and associated facilities at Oroville. The FERC relicensing costs including the costs related to the settlement agreement could total \$90 million or more. The Department may also undertake additional capital projects in the future, which could result in the issuance of additional Bonds or other obligations in substantial amounts. (See “SECURITY FOR THE BONDS – Outstanding Bonds; Additional Bonds” for a description of certain limitations on the issuance of additional Bonds and “STATE WATER PROJECT WATER SUPPLY – Long-Term Planning Efforts for the Delta – *Bay Delta Conservation Plan.*”)

Fish and Wildlife Enhancement and Recreation Costs

The Department is required under the Davis-Dolwig Act, enacted by the Legislature in 1961, to incorporate recreation and fish and wildlife enhancement features in the planning and construction of the State Water Project. The Davis-Dolwig Act provides, in California Water Code section 11913, that it is the intent of the Legislature that there shall be included in the budget for the Department for each fiscal year, and in the

State's budget act for each fiscal year, an appropriation from the General Fund of the funds necessary for enhancement of fish and wildlife and for recreation in connection with state water projects (including the State Water Project). Between 1998 and 2011, no appropriation from the General Fund was made to the Department for these purposes. However, effective with the 2012-2013 fiscal year, legislation was enacted that provides for a continuous annual appropriation of \$10 million from the General Fund portion of the Harbors and Watercraft Revolving Fund to the Department for Davis-Dolwig Act purposes. Seven and one half million dollars of this amount is continuously appropriated each fiscal year for current fish and wildlife enhancement and recreation costs and the other \$2.5 million of this amount is continuously appropriated each fiscal year to reimburse the Department for fish and wildlife enhancement and recreation costs incurred prior to 2012. If additional funding is required for these purposes, the Department will be required to seek additional appropriations.

In 2006, California voters approved Proposition 84 (the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006), which, among other things, authorized the sale of \$54 million in State general obligation bonds for State Water Project recreation and fish and wildlife enhancement purposes. To the extent that sufficient moneys for the enhancement of fish and wildlife and for recreation in connection with state water projects are not made available to the Department through appropriations or the sale of general obligation bonds, costs allocated by the Department to the development of public recreation or fish and wildlife enhancement are expected to be paid by the Department on an on-going basis with State Water Resources Development System revenues available after the payment of operation and maintenance costs, Bond debt service and the PMIA Loan. (See "THE WATER SUPPLY CONTRACTS – Monterey Amendment" and "WATER SUPPLY CONTRACT RELATED LITIGATION – Claims Relating to the Use of Bond Proceeds to Pay Capital Costs Allocable to Recreation and Fish and Wildlife Enhancement.")

Allocation of State Water Project Revenues

Under the California Water Code, State Water Project revenues are allocated between two funds, depending on the source of the revenues.

State Water Project revenues from Water System Projects financed by Bonds are, to the extent allocated to the Bonds, deposited in the Central Valley Project Revenue Fund and pledged to the repayment of Bonds. State Water Project revenues from the Devil Canyon Castaic Facility are deposited in the Central Valley Project Revenue Fund and pledged to the payment of the Devil Canyon Castaic Bonds. State Water Project revenues from the Water System Projects financed by Notes are, to the extent allocated to the Notes, deposited in the Central Valley Project Revenue Fund and pledged to the payment of the Notes.

All other State Water Project revenues are deposited in the California Water Resources Development Bond Fund and used first to pay the reasonable operating and maintenance costs of the State Water Resources Development System (which includes the State Water Project); second, to reimburse the General Fund of the State for the payment of the general obligation bonds issued to finance a portion of the capital costs of the State Water Project; and thereafter to the payment of the costs of the acquisition and construction of the State Water Resources Development System.

Outstanding Revenue Obligations of the Department for the State Water Project

The Department has previously issued forty-four series of Water System Revenue Bonds totaling \$7,987,050,000 in aggregate principal amount, of which \$2,392,740,000 in aggregate principal amount are Outstanding. All of such Bonds are fixed rate bonds and are secured equally and ratably with the Series AS Bonds. (See "PLAN OF REFUNDING.")

The Department has also issued \$1,526,155,000 in aggregate principal amount of revenue bonds secured by three separate bond resolutions to finance certain power facilities of which \$57,430,000 in aggregate

principal amount are outstanding. All bonds issued under two of these resolutions have been fully retired. The outstanding revenue bonds issued under the third resolution are referred to as Devil Canyon-Castaic Bonds. Funds to be available to pay interest on and principal of the Devil Canyon-Castaic Bonds will not constitute Revenues under the Resolution and will not be available to pay interest on or principal of the Bonds. At no time will Revenues be available to pay interest on or principal of the Devil Canyon-Castaic Bonds.

The table below summarizes certain information for the Department’s outstanding long-term revenue bond programs.

	When Issued	Final Maturity	No. of Series	Original Principal Amount in Millions	Outstanding Principal Amount in Millions⁽¹⁾
Devil Canyon-Castaic Bonds ⁽²⁾	1972	2022	1	\$ 139	\$ 57
Water System Revenue Bonds ⁽³⁾	1986-2014	2035	44	7,987	2,393
Total ⁽⁴⁾				<u>\$8,126</u>	<u>\$2,450</u>

(1) Previously refunded bonds and the Series AS Bonds are not included in these totals.

(2) Not secured by the Revenues securing the Bonds.

(3) Does not reflect the issuance of the Series AS Bonds described herein. The Series AS Bonds will be issued in the aggregate principal amount of \$645,795,000 and will refund \$689,780,000 in aggregate principal amount of outstanding Bonds. (See “PLAN OF REFUNDING.”)

(4) Totals may not sum due to rounding.

The Department has authorized the issuance of the Notes in a principal amount outstanding at any one time not to exceed the lesser of \$150,000,000 or the principal amount of Notes supported by the credit agreement then in effect (currently \$139,668,367). The Note program is designed to be an ongoing source of interim financing for Water System Projects prior to permanent financing from the sale of Bonds. The Department currently has approximately \$110,500,000 aggregate principal amount of Notes outstanding, all or a portion of which are expected to be paid with proceeds of the Series AT Bonds expected to be issued in the aggregate principal amount of approximately \$140,000,000 and bearing interest at variable rates. It is anticipated that any remaining principal amount of Notes outstanding and any Notes issued in the future will be refunded periodically by other long-term Bonds. Pursuant to a Revolving Credit Agreement that extends through October 24, 2017, Bank of Montreal, acting through its Chicago Branch has agreed to make advances to the Department, if necessary and subject to certain conditions, to provide moneys for the payment of the Notes when due. The Department may replace the existing revolving credit agreement under the conditions provided by the Note resolution and the agreement. The Notes are payable from the Central Valley Project Revenue Fund and from payments under the Water Supply Contracts. In the event that amounts received by the Department under the Water Supply Contracts are insufficient to pay all amounts due under the Notes, the Bonds and the State’s general obligation bonds issued for the State Water Project, such moneys are to be allocated first to the payment of amounts due under the Bonds and such general obligation bonds.

On April 1, 2008, the Pooled Money Investment Board of the State made a \$29,600,000 loan from the Pooled Money Investment Account to the Department (the “PMIA Loan”) in accordance with California Government Code section 16313, which authorizes the Board to make a loan, on such terms and conditions as the Board may determine, from the Pooled Money Investment Account to any state agency in order to prepay or replace existing financing when the Board determines it is in the best interest of the State to do so. The proceeds of the PMIA Loan together with certain other available funds of the Department were used to retire or provide for the defeasance of approximately \$28.2 million principal amount of certain Bonds and Notes, the proceeds of which were used to pay capital costs allocated to the purposes of fish and wildlife enhancement and the development of public recreation. (See also “WATER SUPPLY CONTRACT RELATED LITIGATION –

Claims Relating to the Use of Bond Proceeds to Pay Capital Costs Allocable to Recreation and Fish and Wildlife Enhancement.”) The Department is paying, and expects to continue to pay, the PMIA Loan solely from “surplus revenues” as defined in California Water Code section 12937(b)(4). None of such surplus revenues are pledged to secure the Bonds, and none of the Revenues pledged to secure the Bonds are available to pay the PMIA Loan. The balance of the PMIA Loan was approximately \$10,724,468 as of September 1, 2014.

The Department currently has no interest rate swaps, caps or hedges or other contingent payment obligations payable from Revenues.

Estimated Annual Debt Service

The following table sets forth the estimated annual debt service for all Bonds that will remain outstanding after giving effect to the issuance of the Series AS Bonds as described in this Official Statement. (See “SECURITY FOR THE BONDS – Outstanding Bonds; Additional Bonds.”)

Year Ending (December 1)	Outstanding Bonds Total Debt Service ⁽¹⁾	Series AS Bonds			Grand Total ⁽²⁾
		Principal	Interest	Debt Service	
2014	\$197,999,544	\$ -	\$ 2,760,227	\$ 2,760,227	\$200,759,771
2015	197,725,248	-	32,051,100	32,051,100	229,776,348
2016	197,057,188	-	32,051,100	32,051,100	229,108,288
2017	195,509,599	-	32,051,100	32,051,100	227,560,699
2018	158,785,320	14,960,000	32,051,100	47,011,100	205,796,420
2019	157,315,495	21,350,000	31,504,000	52,854,000	210,169,495
2020	145,113,186	28,940,000	30,436,500	59,376,500	204,489,686
2021	140,424,123	32,575,000	29,027,250	61,602,250	202,026,373
2022	135,957,194	37,710,000	27,398,500	65,108,500	201,065,694
2023	107,807,691	54,365,000	25,513,000	79,878,000	187,685,691
2024	105,307,705	56,400,000	22,794,750	79,194,750	184,502,455
2025	98,609,724	57,220,000	19,974,750	77,194,750	175,804,474
2026	64,292,604	72,025,000	17,113,750	89,138,750	153,431,354
2027	70,133,148	81,950,000	13,512,500	95,462,500	165,595,648
2028	51,047,916	87,550,000	9,415,000	96,965,000	148,012,916
2029	54,594,838	94,395,000	5,037,500	99,432,500	154,027,338
2030	47,594,325	3,230,000	317,750	3,547,750	51,142,075
2031	49,562,625	1,525,000	156,250	1,681,250	51,243,875
2032	49,562,850	1,600,000	80,000	1,680,000	51,242,850
2033	48,809,025	-	-	-	48,809,025
2034	48,810,550	-	-	-	48,810,550
2035	48,820,588	-	-	-	48,820,588
Total⁽²⁾⁽³⁾	\$2,370,840,482	\$645,795,000	\$363,246,127	\$1,009,041,127	\$3,379,881,609

(1) Excludes debt service on previously refunded Bonds, the Series AS Bonds and the Series AS Refunded Bonds (except for the debt service paid on the Series AS Refunded Bonds on June 1, 2014, which is included).

(2) Totals may not sum due to rounding.

(3) After the issuance of the Series AS Bonds and the refunding with proceeds thereof and other available monies of the Series AS Refunded Bonds the Department will have \$2,348,755,000 in aggregate principal amount of Bonds outstanding. (See “PLAN OF REFUNDING.”)

Article XIII B of the Constitution

Article XIII B of the California Constitution (“Article XIII B”) establishes limits on certain annual appropriations of state and local entities. See “CERTAIN LIMITATIONS ON CONTRACTOR REVENUE SOURCES – Article XIII B of the Constitution.” The Department’s experience is that Article XIII B has not significantly impaired the State’s ability to appropriate funds for the State Water Project.

Article XIII B was adopted pursuant to California’s constitutional initiative process. From time to time other initiatives could be adopted by California voters, placing additional limitations upon the State or the Department.

THE WATER SUPPLY CONTRACTS

The Water Supply Contracts between the State, acting by and through the Department (references to the Department in this Section are to the Department acting in such capacity), and the 29 Contractors are substantially uniform with respect to basic terms except with respect to certain payments by Contractors for agricultural water as noted below. Copies of the Water Supply Contracts between the State and the 29 Contractors are on file at the offices of the Department and of the State Treasurer in Sacramento, and reference is made thereto for information with respect to all of the terms and conditions thereof. The following discussion, except as noted, is applicable to each of the 29 Water Supply Contracts, and assumes the effectiveness of the amendments described below under the heading “Monterey Amendment.” All but two of the Contractors (Plumas County Flood Control and Water Conservation District and Empire West Side Irrigation District) have signed the Monterey Amendment.

Basic Contract

Term. The Water Supply Contracts are to remain in effect for the longest of 75 years, December 31, 2035 or until all bonds issued to finance construction costs of State Water Project facilities have been repaid, whichever period is longest, subject to an election on the part of each Contractor to receive continued service after such longest period on certain specified continued terms and conditions and other reasonable and equitable terms mutually agreed by the Department and the Contractor. (See “THE WATER SUPPLY CONTRACTS – Contract Extension Negotiations.”) The final maturity of the Bonds to be outstanding upon the issuance of the Series AS Bonds will be in 2035. (See “SECURITY FOR THE BONDS – Outstanding Bonds; Additional Bonds.”)

Annual Table A Amounts. The year of initial water delivery is estimated in each Water Supply Contract and a schedule in each of the Water Supply Contracts sets forth the maximum annual amounts of water the Contractor may request to be delivered (“Annual Table A Amount”) commencing in the initial year. These scheduled amounts increase yearly and reach the maximum Annual Table A Amount in a specified year, which for all but thirteen of the Contractors was reached by January 1, 1997. Those thirteen Contractors will reach their respective maximum Annual Table A Amounts on or before 2016. The Annual Table A Amounts schedule may be changed upon request by the Contractor and approval by the Department, but no such change may be made if it would impair the financial feasibility of the State Water Project.

The maximum Annual Table A Amounts of all 29 Contractors presently total 4,172,786 acre-feet of water. (See “STATE WATER PROJECT WATER SUPPLY.”) Water delivered to a Contractor may not be disposed of by the Contractor for use outside the Contractor’s territory, subject to certain limited exceptions, without the Department’s consent. Restrictions are imposed on changes in the corporate organization of the Contractor.

Water Supply. Subject to the availability of funds, the Department is required to make all reasonable efforts consistent with sound fiscal policies, reasonable construction schedules, and proper operating procedures to complete the facilities necessary for water deliveries at the time and in the amounts specified.

The Department must make all reasonable efforts to perfect and protect necessary water rights and must report at least every five years on its ability to meet future water demands.

If the Department cannot complete construction of the aqueducts necessary to deliver water to the Contractor, the Contractor may, under specified circumstances, provide money to the Department necessary to enable the Department to complete construction. In such case, the Department will own and operate the aqueducts, and the amount provided by the Contractor will be credited by the Department against the Contractor's payment obligation under the Water Supply Contracts. Alternatively, the Contractor may connect, at its own expense, to the portion of the aqueduct completed by the Department to receive water to which it is entitled under the Water Supply Contract.

The Department is required to take all reasonable measures to make available water that meets the water quality objectives set forth in the Water Supply Contract.

Allocation of Water Surpluses and Deficiencies. If there is a supply of water in excess of (i) the scheduled deliveries under Table A for all Contractors and (ii) the operational requirements of the State Water Project, Contractors may purchase such surplus water on an interruptible basis. The price of this interruptible water is the incremental cost of delivery.

The Water Supply Contracts also contain provisions for the allocation of water in the event of shortages in water supply. For Contractors that have accepted the Monterey Amendment, the available supply is to be allocated in proportion to Annual Table A Amounts, with reductions for agricultural Contractors and urban Contractors being made on the same basis. Contractors that have accepted the Monterey Amendment as of the date of this Official Statement have over 99 percent of the total Annual Table A Amounts of all Contractors. (See "WATER SUPPLY CONTRACT RELATED LITIGATION – Monterey Amendment Litigation.")

For Contractors that have not accepted the Monterey Amendment, there will be a reduction first in the delivery of water for agricultural purposes by an amount not to exceed 50 percent in any one year or a total of 100 percent of the maximum annual request for agricultural water in any seven consecutive years. Any additional reductions required will be apportioned among all Contractors irrespective of use. In the event of a permanent shortage there will be a proportionate reduction of the Contractors' maximum annual request for water.

Contractors may use aqueduct capacity not used for State Water Project water to transport other water procured by them. The Department is not liable for damage arising from shortages due to causes beyond its control. The total amount of Revenues required to be paid under the provisions of the Water Supply Contracts for the payment of debt service on the Bonds is not dependent on the amount of water available to be delivered.

Water Charges. The Water Supply Contracts in their original form provide for two charges to the Contractor: (a) a Delta Water Charge and (b) a Transportation Charge. The Off-Aqueduct Power Facilities Amendment, East Branch Enlargement Amendment, Water System Revenue Bond Amendment, Coastal Branch Extension Amendment, East Branch Extension Amendment and South Bay Aqueduct Amendment described below (collectively, the "Revenue Bond Amendments") modify the manner of calculating the charges with respect to certain facilities, including certain of the Water System Projects. (See "THE WATER SUPPLY CONTRACTS – Amendments Providing Certain Revenues to Pay Water System Revenue Bonds.")

The original Delta Water Charge and Transportation Charge each consist of three components: (a) a capital cost component; (b) a minimum operation cost component (operation costs that do not vary with water deliveries); and (c) a variable operation cost component (operation costs that vary with water deliveries). Project Planning Costs are charged under the component to which the costs of the potential project being studied would be charged if such project were constructed or acquired.

The original Delta Water Charge is a charge for each acre-foot of maximum Annual Table A Amount. It is computed so as to return to the Department generally during the term of the Water Supply Contract all "reimbursable" costs of the "project conservation facilities," together with interest thereon. The "project conservation facilities" are defined as certain categories of facilities that conserve water. Such facilities now include the Oroville facilities, the Delta facilities, the San Luis facilities and a portion of the aqueduct leading to the San Luis facilities from the Delta. "Reimbursable" costs are those costs determined by the Department to be allocable to the purposes of water conservation (or, in the case of the Transportation Charge, to water transportation). The costs and revenues of powerplants that are part of the "project conservation facilities" (including the Oroville Power Facilities) are included in the determination of the Delta Water Charge.

The original Transportation Charge is computed so as to return to the Department during the term of the contract the "reimbursable" costs of the facilities necessary to deliver water to a Contractor, together with interest thereon. Such facilities include facilities such as aqueducts, pumping plants and on-aqueduct power facilities, but do not include any of the facilities designated by the Resolution as Water System Projects, except for the Alamo Project, Small Hydro Project and Pyramid Hydroelectric Project (which are on-aqueduct power facilities) and except as the Transportation Charge is incorporated by reference in the Water System Revenue Bond Amendment. The costs of the facilities relating to each reach of aqueduct are allocated among all Contractors receiving water through that reach. Each year's capital expenditures are allocated among the Contractors and the allocated amount is required to be paid by each Contractor, together with interest, in not more than 50 equal annual installments within the capital cost component of the Transportation Charge. (In contracts with agricultural water Contractors, these capital costs are repaid by a uniform charge per acre-foot of the maximum annual amount of agricultural water that may be requested, which charge is computed so as to return to the Department generally during the Water Supply Contract term such costs with interest).

The capital cost component of the Transportation Charge and all components of the Delta Water Charge are to be repaid with interest at the weighted average of the rates paid on securities issued to finance the State Water Project (except the Department's commercial paper, the Oroville Bonds and Water System Revenue Bonds) and certain other moneys used to finance the State Water Project. The minimum and variable operation, maintenance, power and replacement cost components (the "operation cost components") of the Transportation Charge are paid currently.

The annual net value of power produced by any powerplant located on a State Water Project aqueduct is credited to all Contractors receiving water flowing through that powerplant in proportion to each Contractor's portion of the total water flowing through the plant during the year. The credit is given in the form of a reduction in the variable operation cost component of each such Contractor's Transportation Charge.

Payment of Water Charges. On or before July 1 of each year, the Department furnishes each Contractor with a statement of estimated charges for the capital cost components (including charges under the Revenue Bond Amendments) and the minimum operation cost components of the Delta Water Charge and Transportation Charge for the following calendar year. The original Delta Water Charge and Transportation Charge capital cost component payments, the East Branch Enlargement Amendment, Coastal Branch Extension Amendment, East Branch Extension Amendment and South Bay Aqueduct Enlargement Amendment revenue bond charges and the Water System Revenue Bond Amendment revenue bond surcharge are due semiannually, on January 1 and July 1 of the year following receipt of the statement of charges. The minimum operation cost component payments of the Delta Water Charge and Transportation Charge and the Off-Aqueduct Power Facilities

Amendment payments are due in twelve monthly installments commencing on January 1 of the year following receipt of the statement of charges.

On or about July 1 of each year, the Department determines the rate (per acre-foot) to be charged each Contractor in the following calendar year for the variable operation cost components of the Delta Water Charge and the Transportation Charge. The variable operation cost components in such calendar year are calculated and billed monthly based on metered water deliveries for the preceding month and an updated rate determined at the beginning of such calendar year. Payment of the variable operation cost components is due on the fifteenth day of the month following receipt of the monthly statement of charges and the Department grants a 30-day grace period, which results in an approximately three-month delay between delivery of water and payment of the variable operation cost components.

On July 1 of each year, the Department furnishes each Contractor with a statement showing the difference between the estimated water charges paid and the actual costs incurred in the prior calendar year. The difference is paid by or credited to each Contractor, as applicable, in equal monthly installments commencing on January 1 of the year following the “true-up” calculation. This process results in an approximately two-year delay in the reconciliation of estimated charges paid and actual costs reimbursed to the Department.

When preparing the statements of charges provided to each Contractor as of July 1, 2014, which provide for the applicable charges for calendar year 2015, the Department took into account all prior year “true-up” calculations, including for calendar years 2013 and 2014, that understated actual and projected costs through 2014 by approximately \$80 million (constituting less than 4% of cumulative charges for such years). Certain costs for those calendar years had been underestimated or were significantly affected by events occurring after the annual statements of charges for those years, including unanticipated maintenance expenses, salary increases and increases in other overhead, resulting in those costs increasing faster than recent historical trends used in estimating them. The Water Supply Contracts provide that the Department may bill for costs in excess of charges for 2013 and 2014 in its charges to the Contractors for calendar year 2015. The unexpected increase in charges in 2015 to account for the uncollected costs for 2013 and 2014 may create fiscal challenges for certain Contractors. The Department is evaluating and intends to take certain actions to mitigate the impact on Contractors.

Interest from the due date at the interest rate earned by the State’s Pooled Money Investment Account must be paid on any payment received more than 30 days after the due date. A Contractor’s failure or refusal to accept delivery of water does not relieve the Contractor of its payment obligations. A Contractor is obligated to make payments to the Department notwithstanding any individual default by its constituents, assignees or others in the payment to the Contractor of charges levied by the Contractor. In accordance with a statutory requirement, each Water Supply Contract requires that whenever the Contractor fails or is unable to raise sufficient funds by other means the Contractor must levy upon all taxable property in the Contractor’s service area a tax or assessment sufficient (with other available moneys) to provide for all payments under the Water Supply Contract. (See “CERTAIN LIMITATIONS ON CONTRACTOR REVENUE SOURCES.”)

If the Contractor defaults in payment, the Department may, and under certain conditions is required to, upon six months’ notice, suspend water deliveries during the period of default. During such period the Contractor remains obligated to make all payments required by the Water Supply Contract and the Department is not deprived of any other remedy under the Water Supply Contract or law.

Revenues from Bond Financed Facilities

Revenues received under the Water Supply Contracts from facilities financed with the Bonds are available to be pledged to the payment of the Bonds. (See “SECURITY FOR THE BONDS.”) Other income

and revenues derived from the Water Supply Contracts are pledged to the purposes and priorities set forth in the Burns-Porter Act, including the payment of certain operation, maintenance and replacement costs of the State Water Project, the payment of debt service on the State general obligation bonds issued under the Burns-Porter Act, the repayment of certain State moneys used for construction, and the payment of costs of acquisition and construction of the State Water Resources Development System (which includes the State Water Project).

The components of the State Water Project financed with Bonds are described in APPENDIX I – “WATER SYSTEM PROJECTS.”

Amendments Providing Certain Revenues to Pay Water System Revenue Bonds

The costs of certain Water System Projects, as that term is defined by the Resolution, are recovered under one of the Water Supply Contract amendments described below.

Off-Aqueduct Power Facilities Amendment. In 1982, the Department and the 29 Contractors entered into a Water Supply Contract amendment, which (a) establishes a separate subcategory of Transportation Charge for Off-Aqueduct Power Facilities, such as the Bottle Rock Project and the South Geysers Project, and changes the method of allocation and payment of costs of such power facilities; (b) authorizes the Department, subject to certain conditions, to include “local water projects” such as ground water storage projects, surface storage projects, wastewater reclamation projects and conservation programs, as projects of the State Water Project with the costs of such projects to be allocated under the Delta Water Charge; (c) changes the interest rate for the penalty for late payments from 6 percent to the interest rate earned by the State’s Pooled Money Investment Account; and (d) specifies that the Department may, subject to certain conditions, charge the Contractors under the Delta Water Charge for water purchased by the Department for delivery through the State Water Project.

Under the Off-Aqueduct Power Facilities portion of the amendment, the annual costs for such facilities financed by Bonds are allocated among the Contractors based upon power consumed in such year in delivering State Water Project water to each Contractor. Such costs include, but are not limited to, debt service, including coverage requirements (such as the requirement of the Resolution that Revenues receivable under the Water Supply Contracts after deduction of the costs of operation and maintenance be at least 1.25 times debt service on the Bonds), deposits to reserves (including the Debt Service Reserve Account) and operation and maintenance expenses, less any credits, interest earnings or other moneys received by the Department in connection with the facility. If the Department determines that the amount received from the Contractors in any year is less than the amount required for such Off-Aqueduct Power Facilities costs, the Department may allocate the deficiency among the Contractors in the same manner as costs are allocated using the original capital cost component of the Transportation Charge.

East Branch Enlargement Amendment. In 1986, the Department entered into a Water Supply Contract amendment with Metropolitan, Antelope Valley-East Kern Water Agency, Coachella, Desert Water Agency, Mojave Water Agency, Palmdale Water District and San Bernardino Valley Municipal Water District (the “Participating Contractors”), for the purpose, among others, of financing the enlargement of the East Branch of the California Aqueduct. The amendment establishes a separate subcategory of Transportation Charge for the East Branch Enlargement and provides for the payment of costs associated with financing and operating the East Branch Enlargement.

Under the East Branch Enlargement Amendment, the annual financing costs for such facilities financed by Bonds are allocated among the Participating Contractors based upon delivery capacity increase allocable to each Participating Contractor. Such costs include, but are not limited to, debt service, including coverage requirements (such as the requirement of the Resolution that Revenues receivable under the Water Supply Contracts after deduction of the costs of operation and maintenance be at least 1.25 times debt service on the

Bonds), deposits to reserves (including the Debt Service Reserve Account) and operation and maintenance expenses, less any credits, interest earnings or other moneys received by the Department in connection with the facility. If any Participating Contractor defaults on payment of its allocable charges under the East Branch Enlargement amendment, among other remedies available to the Department, the non-defaulting Participating Contractors may assume responsibility for such charges and receive delivery capability that would otherwise be available to the defaulting Participating Contractor in proportion to the non-defaulting Participating Contractor's participation in the East Branch Enlargement. If Participating Contractors fail to cure the default, Metropolitan shall, in exchange for the delivery capability that would otherwise be available to the defaulting Participating Contractor, assume responsibility for the capital charges of the defaulting Participating Contractor.

Each Participating Contractor may elect to pay a portion or all of its share of capital costs by advance payment in lieu of participating in revenue bond financing. In an agreement dated June 1, 1987, the San Bernardino Valley Municipal Water District elected to pay a portion of its allocated costs in advance rather than participate in the Bonds issued to finance the East Branch Enlargement-First Stage. No other Participating Contractor has elected to use this advance payment option.

Water System Revenue Bond Amendment. As of 1987, the Department and the 29 Contractors entered into a Water Supply Contract amendment for the purpose of financing facilities, including presently all Water System Projects (as that term is defined under the Resolution) other than Off-Aqueduct Power Facilities, the Alamo Project, the Small Hydro Project, the Pyramid Hydroelectric Project, the East Branch Enlargement – First Stage, the Coastal Branch Extension – Phase II, the East Branch Extension – Phase I and the South Bay Aqueduct Enlargement. The amendment establishes a separate subcategory of Delta Water Charge and Transportation Charge for projects financed with Bonds. This subcategory of charge provides the revenues required to pay the annual financing costs of the Bonds, and consists of two elements. The first element is an annual charge to each Contractor for repayment of capital costs of such projects under the original Water Supply Contract provisions for the Delta Water Charge and the Transportation Charge. The second element is a Bond surcharge to pay the difference between the total annual charges under the first element and the annual financing costs, including coverage and reserves, of the Bonds issued for such projects.

If any Contractor defaults on payment of its allocable charges under this Amendment, the Department must allocate a portion of the default to each of the nondefaulting Contractors, subject to certain limitations, including a provision that no nondefaulting Contractor may be charged more than 125 percent of the amount of its annual payment in the absence of any such default. Under certain circumstances the nondefaulting Contractors would be entitled to receive an allocation of the water supply of the defaulting Contractor.

Coastal Branch Extension Amendment. In 1994, the Department entered into a Water Supply Contract amendment with Santa Barbara County Flood Control and Water Conservation District (“Santa Barbara County FCWCD”), for the purposes, among others, of financing the construction of an extension of the Coastal Branch Aqueduct from the Santa Maria River to the current terminus at Tank 5 near the town of Casmalia. The amendment establishes a separate subcategory of Transportation Charge for the Coastal Branch Extension and provides for the payment of costs associated with financing the Coastal Branch Extension.

Under the Coastal Branch Extension Amendment, the annual financing costs for such facilities are charged to Santa Barbara County FCWCD. Such costs include, but are not limited to, debt service, including coverage requirements (such as the requirement of the Resolution that Revenues receivable under the Water Supply Contracts after deduction of the costs of operation and maintenance be at least 1.25 times debt service on the Bonds) and deposits to reserves (including the Debt Service Reserve Account), less any credits, interest earnings or other moneys received by the Department in connection with the facility.

Santa Barbara County FCWCD had the option to elect to pay a portion of or all of the capital costs of the Coastal Branch Extension by advance payment in lieu of participating in revenue bond financing. Santa Barbara County FCWCD did not use this advance payment option.

Operation and maintenance expenses incurred in connection with the Coastal Branch Extension are included in the minimum operation cost component of the original Transportation Charge. There is no separate minimum operation cost component of the Coastal Branch Extension Transportation Charge.

The Department entered into a joint powers agreement, dated October 1, 1996, with the Central Coast Water Authority to allow the Central Coast Water Authority (“Authority”) to perform both operations and maintenance work on the Coastal Branch – Phase II, from the Polonio Pass Water Treatment Plant to the pipeline terminus. The Authority represents a consortium of thirteen local agencies in Santa Barbara County participating in the Coastal Branch. In 1991, the Authority entered into an agreement with Santa Barbara County FCWCD, which specifies the Authority’s responsibility for implementing the State Water Project in Santa Barbara County.

East Branch Extension Amendment. In March 1997, the Department entered into a Water Supply Contract amendment with San Bernardino Valley Municipal Water District and San Geronio Pass Water Agency, for the purposes, among others, of financing the extension of the East Branch of the California Aqueduct. The amendment establishes a separate subcategory of Transportation Charge for the East Branch Extension and provides for the payment of costs associated with financing the East Branch Extension.

Under the East Branch Extension Amendment, the annual financing costs for such facilities financed by bonds will be allocated between San Bernardino Valley Municipal Water District and San Geronio Pass Water Agency based upon the delivery capacity allocable to each. Such costs include, but are not limited to, debt service, including coverage requirements (such as the requirement of the Resolution that Revenues receivable under the Water Supply Contracts after deduction of the costs of operation and maintenance be at least 1.25 times Bond Debt Service) and deposits to reserves (including the Debt Service Reserve Account), less any credits, interest earnings or other moneys received by the Department in connection with the facility.

Under the East Branch Extension Amendment, each participating Contractor has the option to elect to pay a portion of or all of the capital costs of the East Branch Extension by advance payment in lieu of participating in revenue bond financing. Neither participating Contractor has elected to use this advance payment option.

Operation and maintenance expenses incurred in connection with the East Branch Extension will be included in the minimum operation cost component of the original Transportation Charge. There will be no separate minimum operation cost component of the East Branch Extension Transportation Charge.

In July 2005, the Department and the participating Contractors entered into a Joint Powers Agreement for the coordinated operation and maintenance of the Phase I facilities of the East Branch Extension. That agreement allows the participating Contractors to operate the East Branch Extension and perform some of the required maintenance work.

South Bay Aqueduct Enlargement Amendment. On November 7, 2003, the Department and Alameda County Flood Control and Water Conservation District, Zone 7 (“Zone 7”) entered into a South Bay Aqueduct Enlargement Amendment to their Water Supply Contract for the purpose of financing the enlargement of the South Bay Aqueduct. This amendment established a separate subcategory of Transportation Charge for the South Bay Aqueduct Enlargement and provides for the payment of costs associated with financing and operating the South Bay Aqueduct Enlargement facilities. The annual costs for such facilities are borne exclusively by Zone 7 including debt service, deposits to reserves and operation and maintenance expenses, less any credits,

interest earnings or other moneys received by the Department in connection with such facilities. Under the South Bay Aqueduct Enlargement Amendment, Zone 7 may elect to pay a portion of its entire share of capital costs by advance payment in lieu of participating in revenue bond financing. Operation and maintenance expenses incurred in connection with the South Bay Aqueduct Enlargement will be included in the minimum component of the South Bay Aqueduct Enlargement Transportation Charge.

Monterey Amendment

In December 1994, the Department and representatives of certain of the Contractors reached an agreement on comprehensive principles that served as the basis for negotiating amendments to the Water Supply Contracts. These amendments are collectively known as the “Monterey Amendment.” The Monterey Amendment was negotiated subject to the provision of the Resolution that the Department shall not agree to any amendment to the Water Supply Contracts that would materially adversely affect the security of the Bonds.

Water Supply Contract provisions that have been amended or added by the Monterey Amendment include provisions relating to the allocation of water (both in the event of a shortage and in the event of surplus), the transfer of the land and related assets of the Kern Fan Element of the Kern Water Bank to Kern County Water Agency (“KCWA”), the operation of certain State Water Project reservoirs, transfers of State Water Project Annual Table A Amounts (including certain transfers from agricultural Contractors to urban Contractors), other water transfers, the creation of and limitations on a Department reserve for operation, maintenance and replacement costs, and the description of facilities that may be financed with revenue bonds (adding a corporation yard and an operations center).

In addition, the Monterey Amendment provides for the reduction of annual Water Supply Contract charges in a manner such that Water Supply Contract revenues (taking into account other revenues and credits) are at levels calculated to meet (but not exceed) the following “revenue needs”: (1) annual financing requirements (including debt service and coverage) for revenue bonds, including the Bonds, issued for State Water Project facilities, (2) operation and maintenance expenses of the State Water Resources Development System (which includes the State Water Project, the Davis-Grunsky Act Program and the San Joaquin Drainage Program), (3) debt service on general obligation bonds issued under the Burns-Porter Act, (4) \$4.5 million per year for capital costs of the State Water Project and the San Joaquin Drainage Program for which neither general obligation bond nor revenue bond proceeds are available, and (5) after the provision of at least \$40.5 million per year of reductions in charges to the Contractors, the amounts available and needed for certain “additional State Water Resources Development System purposes.”

By August 1999, the Department had executed the Monterey Amendment with 27 of the Contractors. The Contractors that have signed the Monterey Amendment have approximately 99 percent of the maximum Annual Table A Amounts and make approximately 99 percent of the annual Water Supply Contract payments. The Department believes that it can administer the State Water Project in a manner such that both the Contractors that have not signed the Monterey Amendment and the Contractors that have signed the Monterey Amendment will receive the benefits and have the obligations provided in their respective Water Supply Contracts, amended or not as the case may be.

Pending litigation relating to the Monterey Amendment is described under “WATER SUPPLY CONTRACT RELATED LITIGATION – Monterey Amendment Litigation.”

Contract Extension Negotiations

In May 2013, the Department and the Contractors began negotiations in a public forum to develop contract amendments to extend the term and change certain financial provisions of the Water Supply Contracts. In June 2014, the Department and the Contractors reached a general agreement on principles for such an

amendment (the “Agreement in Principle”). Currently, the Water Supply Contracts are to remain in effect for the longest of 75 years, December 31, 2035 or until all bonds issued to finance construction costs of State Water Project facilities have been repaid, whichever period is longest, subject to an election on the part of each Contractor to receive continued service after such longest period on certain specified continued terms and conditions and other reasonable and equitable terms mutually agreed by the Department and the Contractor. No Bonds have been sold with a maturity date later than December 1, 2035. The 75 year term provision currently results in the Water Supply Contracts having varying termination dates that range between December 31, 2035 and 2042, subject to the aforementioned election. Under the Agreement in Principle the term of the Water Supply Contract for each Contractor that signs an amendment would be extended until December 31, 2085.

Also under the Agreement in Principle, certain provisions that provide for charges to the Contractors for capital costs and certain other costs to be made on an amortized basis would be amended to provide for charges to the Contractors on an annual “pay as you go” basis to provide the revenues needed by the Department to make payments in each year. The current provisions authorizing the Department to charge the Contractors annually for the full amount of the required annual debt service and coverage on the Bonds will continue in any extended contract. Other provisions addressed in the Agreement in Principle would provide for, among other things, an increase in the Department’s operating reserves, a mechanism for financing capital projects with Project funds and recovering those costs with interest from the Contractors, establishment of an account to pay for certain State Water Resources Development System expenses not chargeable to the Contractors and the establishment of a Finance Committee consisting of Department and Contractor representatives to serve as a forum for discussions and to provide a channel for recommendations to the Director of Water Resources concerning financial policies of the Project.

Environmental review pursuant to CEQA and a presentation by the Department in an informational hearing to the Legislature will be part of the contract extension amendment process before any contract amendment is adopted. Any amendment that is ultimately adopted will comply with the Department’s covenant in the Resolution not to agree to any amendment to the Water Supply Contracts which would materially adversely affect the security for the Bonds.

Obligation to Levy Taxes or Assessments

The Water Supply Contracts, in accordance with a statutory requirement, provide that whenever a Contractor fails or is unable to raise sufficient funds by other means, the Contractor must levy on all property in the Contractor’s territory not exempt from taxation a tax or assessment sufficient to provide for all payments under the Water Supply Contract.

Although Article XIII A of the California Constitution added to the California Constitution in 1978, limits the imposition of *ad valorem* property taxes. (See “CERTAIN LIMITATIONS ON CONTRACTOR REVENUE SOURCES”), the California Court of Appeal concluded that taxes levied by the Contractors to make payments under the Water Supply Contracts come within the Section 1(b) exception [in Article XIII A for] “*ad valorem* taxes or special assessments to pay the interest and redemption charges on . . . any indebtedness approved by the voters prior to July 1, 1978” to the general taxing limitation imposed by Article XIII A. (*Goodman v. County of Riverside*, 140 Cal. App. 3d 900 (1983)). As a result of this finding, the Court determined there was no need to address the issue of whether the application of Article XIII A to limit the levying of taxes to make payments under the Water Supply contracts would constitute an unconstitutional impairment of contract. The Court stated:

“ . . . [W]e conclude, when the state’s voters approved the Act, that they approved an indebtedness in the amount necessary for building, operating, maintaining, and replacing the Project, and that they intended that the costs were to be met by payments from local agencies with water contracts. Further, we conclude that the voters necessarily approved the use of local property taxes whenever the boards of directors of the agencies determined

such use to be necessary to fund their water contract obligations, and that the *ad valorem* taxes levied by [Desert Water Agency] fall within the exception of section 1, subdivision (b) [of Article XIII A].

Our conclusion here does away with the necessity to address the issue of impairment of contractual obligations.”

The California Supreme Court denied a petition for hearing on July 14, 1983.

WATER SUPPLY CONTRACT RELATED LITIGATION

The Department is a party to several lawsuits respecting the Water Supply Contracts as described below.

Monterey Amendment Litigation

In May 2003, the trial court approved a settlement agreement among the Department and the other parties in *Planning and Conservation League, et al. vs. Department of Water Resources and Central Coast Water Authority*, a lawsuit that challenged the Monterey Amendment. Under the settlement agreement, the Department agreed, among other things, to act as lead agency in the preparation of a new EIR for the Monterey Amendment. During the preparation and processing of the new EIR, the Department was permitted under the settlement agreement to continue to operate the State Water Project in accordance with the provisions of the Monterey Amendment, including the provisions pertaining to the transfer of land and related assets of the Kern Fan Element of the Kern Water Bank to KCWA. The Department also agreed to pay for certain watershed improvements in Plumas County and to pay the plaintiffs certain amounts for use in implementing the settlement agreement. The plaintiffs agreed to limit the grounds upon which they could challenge the new EIR after it is completed.

The parties to the lawsuit had engaged in settlement discussions after the Court of Appeal, in September 2000, reversed an earlier trial court ruling on the Monterey Amendment EIR. The trial court had found that the designation of the Central Coast Water Authority (“CCWA”), rather than the Department, as the lead agency for the Monterey Amendment EIR, violated the California Environmental Quality Act, but that the Monterey Amendment EIR was adequate, and the error as to the lead agency was harmless. As a result of the trial court’s ruling, the Department had proceeded to implement the Monterey Amendment, including transferring the Kern Fan Element property to KCWA. The Court of Appeal found that the Monterey Amendment EIR was inadequate because it failed to address all of the impacts of deleting a contract provision that would allow the Department to declare a permanent water shortage on the State Water Project and reduce the maximum annual amounts of water that may be requested. The California Supreme Court declined to review the case. The Court of Appeal remanded the case to the trial court to oversee the Department’s preparation of a new EIR and to consider whether the Monterey Amendment may continue to be implemented while the new EIR is being prepared. The May 2003 settlement agreement described in the immediately preceding paragraph addressed these issues.

In accordance with the Court of Appeal’s determination, the Department undertook preparation of the EIR in January 2003 and completed the Final EIR in February 2010. The Department filed its Notice of Determination in May 2010. In June 2010, two Delta water agencies and several environmental organizations and individuals filed a lawsuit in Sacramento County Superior Court challenging the Department’s CEQA compliance and the validity of the Monterey Amendment, including the Department’s transfer of the Kern Fan Element to the KCWA. In July 2010, the same plaintiffs in the Sacramento County Superior Court case filed a lawsuit in Kern County Superior Court challenging the transfer of the Kern Fan Element from KCWA to the Kern Water Bank Authority, a local joint powers agency which now has responsibility for the management of the Kern Fan Element and the Kern Water Bank. In addition, in June 2010, two water districts in Kern County filed a separate lawsuit in Kern County Superior Court, challenging primarily the Department’s CEQA compliance with respect to the Kern Fan Element transfer from the Department to KCWA. The two lawsuits

filed in Kern County Superior Court have been transferred to the Sacramento County Superior Court. In December 2012, the Department prevailed on its challenge to the plaintiffs' validation causes of action (including the validity of Kern Fan Element transfer) on the grounds that they were not timely filed. This leaves only the plaintiffs' CEQA compliance challenge, unless the plaintiffs appeal and are successful in their appeal to reinstate the validation causes of action. After holding a hearing on the CEQA challenges in the remaining two cases, the trial court ruled that most of the EIR is adequate under CEQA, but that the EIR's discussion of the Kern Water Bank's future impacts is insufficient. The Court therefore issued a decision in favor of the plaintiffs in the two cases finding that the EIR failed to analyze impacts associated with the use and operation of the Kern Water Bank, particularly as to potential groundwater and water quality impacts. The Court will be ordering a remedy regarding its finding that the EIR failed to sufficiently analyze the Kern Water Bank impacts. The Department, however, does not expect that there would be any material adverse impact on the ability of the Department to meet its payment obligations, including those with respect to the Bonds, even if these lawsuits are successful.

Contractor Lawsuit Regarding Oroville Power Credits

On April 25, 2005, 14 Contractors filed a lawsuit against the Department in Sacramento County Superior Court for declaratory relief and breach of contract. The complaint alleged that pursuant to the Water Supply Contracts, the Department was required, but failed, to credit all revenues from power generated by certain State Water Project conservation facilities (primarily the Hyatt and Thermalito Powerplants) to the Delta Water Charge, and, as a result, overcharged the Contractor plaintiffs. The fourteen Contractors are: Alameda County Flood Control and Water Conservation District, Zone 7; Alameda County Water District; City of Yuba City; County of Butte; County of Kings; Dudley Ridge Water District; Empire West Side Irrigation District; KCWA; Napa County Flood Control and Water Conservation District; Oak Flat Water District; Plumas County Flood Control and Water Conservation District; Santa Clara Valley Water District; Solano County Water Agency; and Tulare Lake Basin Water Storage District. The complaint sought a declaration that all "benefits" derived from the sale or other disposal of power from State Water Project conservation facilities be credited "in conformity with the terms of the Water Supply Contracts" and damages and costs in an unspecified amount. In December 2005, entities representing thirteen other Contractors intervened in the lawsuit in opposition to the claims of the plaintiffs. The remaining two Contractors were joined as indispensable parties. The trial in this case took place before a judge in November and December 2008. In May 2010, the court entered its judgment in favor of the Department and the intervening Contractors, finding that the Department's determinations and administration of the provisions regarding the Delta Water Charge power revenue credits were consistent with the Water Supply Contracts. The Contractor plaintiffs appealed the lower court's decision to the Court of Appeal and in February 2013 the Court of Appeal issued its decision upholding the judgment of the trial court in favor of the Department and the intervening Contractors. The Contractor plaintiffs did not seek any further review of the case, so the Court of Appeals decision is final and the case is concluded.

Claims Relating to the Use of Bond Proceeds to Pay Capital Costs Allocable to Recreation and Fish and Wildlife Enhancement

The State Water Project has multiple purposes, including water conservation, water transportation, power generation, flood control, public recreation, and fish and wildlife enhancement. California Water Code Section 11912 provides that costs incurred for the enhancement of fish and wildlife or for the development of public recreation may not be included in the Department's prices, rates and charges for water and power. Under the terms of the Water Supply Contracts, the Department may only charge amounts that recover costs allocable to water conservation and water transportation (including the costs of mitigation of the fish and wildlife impacts arising from water conservation and transportation activities).

In December 2005, Metropolitan filed a "Notice of Contest" with the Department, challenging various charges in the Department's billings. Based on its Notice of Contest, Metropolitan also filed a claim with the

Victim Compensation and Government Claims Board, which claim was denied by the Board in March 2006. The Department and Metropolitan entered into a tolling agreement extending Metropolitan's time to file a lawsuit on the denied claim until March 31, 2007. The tolling of Metropolitan's time to file a lawsuit has been extended to December 31, 2015 in connection with the broader Tolling and Waiver Agreement described below.

One of the claims made by Metropolitan was that (1) Bond proceeds had been spent on the capital costs of certain recreation and fish and wildlife enhancement facilities that are a part of or are related to certain water system projects, (2) the Contractors had been charged under the Water Supply Contracts for costs relating to such recreation and fish and wildlife enhancement facilities (the "Recreation Costs"), and (3) such charges are not authorized by State law.

In the course of its investigation of Metropolitan's claims, the Department determined that it had spent approximately \$26.3 million of Bond proceeds and \$2.7 million of commercial paper proceeds on capital costs allocated by the Department to the purposes of recreation and fish and wildlife enhancement, had charged the Contractors approximately \$9.5 million for Bond debt service allocated to recreation and fish and wildlife enhancement and had paid approximately \$15.1 million of such financing costs with other revenues. The Department has issued restated bills to the Contractors for the years 1988 through 2007. This restatement has, among other things, credited back the \$9.5 million, plus interest, and restated the amount of "reductions in charges" made and to be made available to the Contractors under the Monterey Amendment to reflect the use of other revenues that are permitted to be used to pay financing costs of the Bonds allocable to recreation and fish and wildlife enhancement. (See "THE WATER SUPPLY CONTRACTS – Monterey Amendment.") One of the effects of such credits and restatements was to shift aggregate Water Supply Contract charges for the years 1997 through 2006 in the amount of approximately \$5 million among the Contractors, with some Contractors' aggregate Water Supply Contract charges being increased and other Contractors' aggregate Water Supply Contract charges being decreased. The Department has also filed with the State Treasurer, as trustee under the Resolution, a supplemental resolution (and an amendment to such supplemental resolution) determining and designating that the other revenues used to pay Bond debt service are Revenues under the Resolution.

In 2007 and 2008, the Department entered into a Tolling and Waiver Agreement with 28 of the 29 Contractors. The Contractors that have signed the Tolling and Waiver Agreement have more than 99 percent of the maximum Annual Table A Amounts and make more than 99 percent of the annual Water Supply Contract payments. The Tolling and Waiver Agreement, as amended, expires on December 31, 2015. Under the Tolling and Waiver Agreement (as amended), each signing Contractor agrees that in order to facilitate Department financing transactions or other transactions that are to be secured by the revenues available to the Department under the Water Supply Contracts, and without establishing any precedent for interpretation of the Water Supply Contracts or the Davis-Dolwig Act, (California Water Code sections 11900-11925), each Contractor signing the agreement waives and releases any "Claims" based on or asserting the following:

(a) That the Department is not in compliance with its Resolution covenants or that the Contractor has any right to recover anything of value from Bondholders in their capacities as Bondholders arising out of or related to any "Claims" (defined as claims arising out of or related to (1) the Metropolitan claims; (2) the use, prior to July 1, 2006, of Bond proceeds or commercial paper proceeds to pay costs incurred for the enhancement of fish and wildlife or for the development of public recreation; (3) the related establishment, restatement or adjustment of charges and rate reductions under the Water Supply Contracts; (4) the accounting for the costs of the San Joaquin Drainage Program; (5) the allocation of certain costs in the Delta to the purposes of the development of public recreation and the enhancement of fish and wildlife; or (6) the Department's bills to the Contractors for 2007 through 2011, to the extent related to the foregoing); and

(b) That, so long as Water Supply Contract charges are properly based (without regard to Article 51 of the Water Supply Contracts (the "rate reductions" portion of the Monterey Amendment)) solely on water conservation and water transportation costs,

(i) the use of “System Revenues” (defined below) to satisfy the rate covenant of the Resolution or the commercial paper note resolution with respect to Bonds and commercial paper issued prior to July 1, 2006 (or obligations issued to refund such Bonds and commercial paper, but not including amounts needed for the payment of any “Defeasance Loan” (defined below)) (A) is not a “revenue need” under the Monterey Amendment, (B) is a violation of California Water Code Section 11912, or (C) is a breach of Water Supply Contracts; or

(ii) the use of System Revenues to pay a Defeasance Loan (A) is not an “additional State Water Resources Development System purpose” under the Monterey Amendment, (B) is a violation of California Water Code section 11912, or (C) is a breach of the Water Supply Contracts.

“System Revenues” is defined by the Tolling and Waiver Agreement to mean all revenues derived from the sale, delivery or use of water or power, and all other income or revenue derived by the Department from the State Water Resources Development System (which includes the State Water Project).

“Defeasance Loan” is defined by the Tolling and Waiver Agreement to mean any loan from the State General Fund, the Pooled Money Investment Account or other appropriate source obtained for the purpose of the retirement or defeasance of the Department’s commercial paper and/or revenue bonds outstanding as of July 1, 2006, the proceeds of which were used to pay capital costs of development of public recreation or fish and wildlife enhancement (or which refunded commercial paper and/or revenue bonds, the proceeds of which were used to pay capital costs of development of public recreation or fish and wildlife enhancement).

The Tolling and Waiver Agreement, as amended, also tolls (i.e., suspends) until December 31, 2015, the running of the time period and statute of limitations for filing by the Contractors of (1) protests regarding the Department’s bills to the Contractors for 2007 through 2016, (2) claims arising from the Department’s revisions to prior year invoices that were made to adjust for improper charges to the Contractors for recreation and fish and wildlife enhancement costs, and (3) certain other specified claims.

No assurance can be given that Contractors will not file additional Notices of Contest, claims and/or lawsuits with respect to such restatements of the amount of reductions in charges under the Monterey Amendment. If successful, such claims may reduce the amount of Revenues available under the Resolution.

The proceeds of the PMIA Loan in the amount of \$29,600,000 together with certain other available funds of the Department were used to retire or provide for the defeasance of approximately \$28.2 million principal amount of Bonds and Notes, the proceeds of which were used to pay costs allocated by the Department to the development of public recreation or fish and wildlife enhancement (or which refunded commercial paper and/or revenue bonds, the proceeds of which were used to pay capital costs of development of public recreation or fish and wildlife enhancement). The Department no longer allocates proceeds of Notes or Bonds to the development of public recreation or fish and wildlife enhancement and, accordingly, neither the Bonds remaining outstanding nor any additional Bonds will be treated by the Department as Notes or Bonds, the proceeds of which were used to pay, directly or indirectly, costs allocable to the development of public recreation or fish and wildlife enhancement.

Contractor Area of Origin Claims

In July 2008, Contractors Solano County Water Agency, Napa County Flood Control & Water Conservation District, Butte County and Yuba City filed a lawsuit against the Department in State court alleging that they have area of origin rights under California Water Code section 11460 and that they are therefore entitled to their full water supply under their respective Water Supply Contracts during periods of water shortage, as long as the State Water Project is exporting water. These Contractors claim that the deficiency provisions of the long-term Water Supply Contracts, which specify the manner in which the Department is

required to allocate shortages of water among all Contractors, do not apply to them. The parties have settled the case and the Court has issued an order dismissing the case. Pursuant to the settlement, the four Contractors' Water Supply Contracts were amended to allow periodic increases in each of the four Contractors water allocations during certain dry water conditions, without increasing any individual Contractor's Table A Amount.

THE CONTRACTORS

The 29 Contractors are principally located in the San Francisco Bay area, the Central Coast, the Central Valley and Southern California and their service areas encompass approximately 39,200 square miles, approximately 25 percent of the State's land area, with a population of approximately 26 million, or about 71 percent of the State's population.

With three exceptions, the Contractors are established as districts under various State statutes providing for the formation of districts for water-related purposes. One Contractor is a city and two are counties. Of the 29 Contractors, 24 provide water primarily for municipal and industrial purposes and five provide water primarily for agricultural purposes.

The State Water Project was designed to be a supplemental source of water for Contractors, not an exclusive source, and Contractors have various other sources of water supply.

Certain of the Contractors also provide other services, including flood control, ground water replenishment, sewage collection and disposal, solid waste and trash collection and disposal, hydroelectric power generation and first aid, ambulance and paramedical services.

Governing Bodies

Eight of the Contractors are governed by county boards of supervisors, 19 by elected boards of directors, and one by its city council. Metropolitan's board of directors consists of representatives appointed by the governing bodies of its constituent public agencies. Boards of supervisors generally include five members who are elected by popular vote. Specially elected governing boards generally include between five and eleven members and are elected by registered voters except for a few districts in agricultural areas, where the vote is based upon ownership of land in the district.

Water Rates and Taxation

Rates and charges of the Contractors are generally set by each Contractor's governing body and are not presently subject to any state or federal regulatory agency.

Many Contractors receive a major portion of their income from *ad valorem* taxes on property and some make all payments under their Water Supply Contracts from *ad valorem* taxes. (See APPENDIX A – "ESTIMATED DIRECT AND OVERLAPPING DEBT.") The ability of Contractors to tax for general purposes and to appropriate for general purposes from tax revenue is limited under California law. (See "CERTAIN LIMITATIONS ON CONTRACTOR REVENUE SOURCES.")

Selected Contractor Data

The table entitled "Selected Data on the Contractors" sets forth for each Contractor the year in which it was established, its estimated population and principal water-related activities.

SELECTED DATA ON THE CONTRACTORS

Contractor	Year Established	Estimated December 31, 2012 Population	Principal Water Related Activities
Alameda County Flood Control and Water Conservation District, Zone 7	1967	224,000	Treats, distributes, and stores State water for municipal and agricultural purposes.
Alameda County Water District	1913	331,000	Treats and distributes State water for municipal purposes. Uses State water to replenish ground water basins for municipal and agricultural purposes as well as for salt water barrier protection for ground water basins.
Antelope Valley-East Kern Water Agency	1959	312,283	Distributes State water for agricultural purposes. Treats and distributes State water for municipal purposes.
Castaic Lake Water Agency	1962	272,200	Treats and distributes State water for municipal purposes.
City of Yuba City	1908	63,338	Treats and distributes State water for municipal purposes.
Coachella Valley Water District	1918	303,846	Exchanges State water for water from Metropolitan for storage in underground basins and for distribution for agricultural purposes.
County of Butte	1850	221,609	Distributes State water for municipal purposes.
County of Kings	1893	150,843	Exchanges State water for water from the Tulare Lake Basin Water Storage District for recreational purposes.
Crestline-Lake Arrowhead Water Agency	1962	23,413	Treats and distributes State water for municipal purposes.
Desert Water Agency	1961	71,072	Exchanges State water for water from Metropolitan for storage in underground basins and distribution for municipal purposes.
Dudley Ridge Water District	1963	36	Distributes State water for agricultural purposes.
Empire West Side Irrigation District	1931	11	Distributes State water for agricultural purposes. Exercises surface water rights.
Kern County Water Agency	1961	851,710	Distributes State water to 16 districts for agricultural and municipal use. Replenishes ground water basins with State water for municipal and agricultural use. Exercises flood control functions.
Littlerock Creek Irrigation District	1892	2,900	Distributes State water for agricultural purposes.
The Metropolitan Water District of Southern California	1928	18,202,432	Transmits and distributes State water and water from the Colorado River to 27 public agencies for municipal, agricultural and ground water replenishment purposes.
Mojave Water Agency	1960	458,897	Distributes State water for municipal purposes and uses State water to replenish ground water basins.
Napa County Flood Control and Water Conservation District	1951	139,045	Distributes water for municipal purposes. Exercises flood control functions.
Oak Flat Water District	1964	10	Distributes State water for agricultural purposes.
Palmdale Water District	1918	114,553	Treats and distributes State water for municipal purposes.
Plumas County Flood Control and Water Conservation District	1967	21,200	Distributes State water. Exercises flood control functions.
San Bernardino Valley Municipal Water District	1954	661,546	Uses State water to replenish ground water basins and for municipal purposes.
San Gabriel Valley Municipal Water District	1959	197,636	Uses State water to replenish ground water basins.
San Geronio Pass Water Agency	1961	78,268	Uses State water to replenish ground water basins and for municipal purposes.
San Luis Obispo County Flood Control and Water Conservation District	1945	274,804	Has contracted for State water. Exercises flood control functions.

Contractor	Year Established	Estimated December 31, 2012 Population	Principal Water Related Activities
Santa Barbara County Flood Control and Water Conservation District	1956	381,562	Has transferred its rights under its Water Supply Contract to the Central Coast Water Authority, which will distribute State water for municipal purposes. Exercises flood control functions.
Santa Clara Valley Water District	1951	1,781,642	Treats and distributes State water for municipal purposes. Distributes State water for agricultural purposes and for replenishment of ground water basins. Exercises flood control functions.
Solano County Water Agency	1958	415,913	Distributes State water for municipal purposes. Exercises flood control functions.
Tulare Lake Basin Water Storage District	1926	23	Distributes State water for agricultural purposes. Exercises surface water rights.
Ventura County Flood Control District	1944	464,600	Purchases State water and sub-contracts the entire amount to Casitas Municipal Water District. While Casitas manages the facility, Ventura County has primary responsibility for payment for State water. Exercises flood control functions.
Total		26,021,400	

Source: Department of Water Resources, State Water Project Analysis Office.

Water Deliveries and Contractor Payments

The tables on the following pages show, for the last five calendar years, historical water deliveries from the State Water Project to each Contractor and historical payments under the Water Supply Contracts and under the Devil Canyon Castaic Contract by each Contractor.

Historical Deliveries of Water from the State Water Project to the Contractors ⁽¹⁾ (in acre-feet)

Contractor	2009	2010	2011	2012	2013	Maximum Annual Table A Amount ⁽²⁾
Alameda County Flood Control and Water Conservation District, Zone 7	31,044	47,343	52,972	55,239	44,954	80,619
Alameda County Water District.....	19,452	22,571	36,610	20,831	23,640	42,000
Antelope Valley-East Kern Water Agency	45,747	58,489	94,046	111,207	51,003	141,400
Castaic Lake Water Agency.....	42,085	56,033	39,241	50,473	44,754	95,200
City of Yuba City.....	2,114	2,331	2,297	2,695	4,850	9,600
Coachella Valley Water District	46,022	85,592	79,464	117,587	66,539	138,350
County of Butte.....	581	807	1,092	1,374	908	27,500
County of Kings.....	3,391	4,679	6,556	7,405	4,645	9,305
Crestline-Lake Arrowhead Water Agency.....	865	357	192	624	1,368	5,800
Desert Water Agency.....	18,263	31,183	32,021	45,101	20,791	55,750
Dudley Ridge Water District.....	21,237	27,967	60,074	30,450	32,770	50,343
Empire West Side Irrigation District.....	1,034	3,259	1,915	2,242	1,567	3,000
Kern County Water Agency.....	759,025	697,958	1,200,563	782,155	744,317	982,730
Littlerock Creek Irrigation District	42	-	-	-	-	2,300
The Metropolitan Water District of Southern California	929,667	1,416,045	1,700,473	1,224,907	892,550	1,911,500
Mojave Water Agency	29,067	38,152	5,099	11,244	7,498	82,800
Napa County Flood Control and Water Conservation District.....	10,904	12,417	11,275	9,904	12,478	29,025
Oak Flat Water District.....	1,993	2,906	2,715	3,208	2,820	5,700
Palmdale Water District.....	15,339	10,969	17,313	18,897	10,567	21,300
Plumas Co. Flood Control and Water Conservation District	200	243	98	79	366	2,700
San Bernardino Valley Municipal Water District.....	38,304	49,379	30,060	112,972	32,085	102,600
San Gabriel Valley Municipal Water District.....	11,520	19,180	23,591	22,058	9,252	28,800
San Geronio Pass Water Agency	6,397	8,240	10,503	11,010	9,445	17,300
San Luis Obispo Co. Flood Control and Water Conserv. Dist.....	3,801	3,757	4,631	3,944	3,681	25,000
Santa Barbara Co. Flood Control and Water Conserv. Dist. ⁽³⁾	15,452	17,775	22,786	19,474	18,018	45,486
Santa Clara Valley Water District.....	68,194	107,871	131,237	63,794	84,623	100,000
Solano County Water Agency.....	30,950	30,816	28,034	29,350	35,929	47,756
Tulare Lake Basin Water Storage District	36,846	70,238	63,141	95,717	48,361	88,922
Ventura County Flood Control District.....	3,891	4,075	4,000	4,353	2,890	20,000
TOTAL.....	2,193,427	2,830,632	3,661,999	2,886,168	2,212,669	4,172,786

⁽¹⁾ Historical deliveries reflect changes resulting from the reclassification of State Water Project (SWP) water to or from these water types: flexible withdrawal, Non-SWP local water rights, or Non-SWP water.

⁽²⁾ Reflects permanent transfers of Table A Amounts through December 31, 2013. For an explanation of Table A Amounts see "THE WATER SUPPLY CONTRACTS--Basic Contract--Annual Table A Amounts."

⁽³⁾ As of July 1, 1989, Santa Barbara County FCWCD transferred certain of its rights under its Water Supply Contract to certain local water purveyors and users within Santa Barbara County. Thereafter, on September 26, 1991, the local water purveyors and users transferred those rights to the Central Coast Water Authority in consideration for its agreement to provide for the delivery of State Water Project water to the local water purveyors and users. Although the Department did not object to these transfers, the Department considers Santa Barbara County FCWCD to be the party to which the Department is obligated under the Water Supply Contract, and the Department did not release Santa Barbara County FCWCD from its Water Supply Contract obligations.

Source: Department of Water Resources, State Water Project Analysis Office.

Historical Payments to the Department from the Contractors⁽¹⁾
(in thousands)

Contractor	2009	2010	2011	2012	2013
Alameda County Flood Control and Water Conservation District, Zone 7	\$ 23,143	\$ 25,842	\$ 26,969	\$ 32,995	\$ 33,678
Alameda County Water District	6,549	6,233	6,244	8,981	7,476
Antelope Valley-East Kern Water Agency	29,559	27,781	27,238	31,090	34,158
Castaic Lake Water Agency	22,255	19,117	19,814	25,540	21,678
City of Yuba City	357	428	498	497	518
Coachella Valley Water District	57,555	48,405	35,892	56,834	55,089
County of Butte	864	1,072	1,264	1,423	1,484
County of Kings	743	729	797	829	834
Crestline-Lake Arrowhead Water Agency	1,731	1,332	1,668	1,718	1,975
Desert Water Agency	21,222	17,328	10,898	22,608	19,632
Dudley Ridge Water District	4,978	3,840	4,295	4,595	4,462
Empire West Side Irrigation District ⁽³⁾	207	226	200	259	241
Kern County Water Agency	97,825	98,494	97,983	112,068	111,440
Littlerock Creek Irrigation District	738	398	711	563	591
The Metropolitan Water District of Southern California	667,895	540,116	619,293	555,505	564,019
Mojave Water Agency	24,906	22,812	32,331	23,528	23,597
Napa County Flood Control and Water Conservation District	5,729	6,713	8,896	8,894	8,157
Oak Flat Water District	348	358	409	334	536
Palmdale Water District	6,566	5,492	5,606	5,425	4,777
Plumas County Flood Control and Water Conservation District ⁽³⁾	97	120	130	141	151
San Bernardino Valley Municipal Water District	54,741	39,054	47,372	43,642	42,481
San Gabriel Valley Municipal Water District	11,923	9,284	7,902	9,332	8,450
San Geronio Pass Water Agency	20,198	14,933	14,324	14,676	15,349
San Luis Obispo Co. Flood Control and Water Conservation District	8,565	5,701	5,931	6,966	6,936
Santa Barbara Co. Flood Control and Water Conservation District ⁽²⁾	44,303	41,264	46,884	37,531	43,503
Santa Clara Valley Water District	17,036	17,213	17,718	23,489	20,154
Solano County Water Agency	8,017	7,657	9,384	10,328	14,052
Tulare Lake Basin Water Storage District	8,206	7,910	7,303	8,480	8,113
Ventura County Flood Control District	6,690	4,158	6,052	5,103	4,478
TOTAL⁽⁴⁾	\$1,152,948	\$974,010	\$1,064,006	\$1,053,374	\$1,058,009

⁽¹⁾ Contractor payments made in each year include the payment of 125 percent of annual debt service for the Bonds in that year, the amount of such payments that is not required to pay debt service on the Bonds in that year is credited back to the Contractors, the historical payments do not reflect such credits or any other subsequent adjustments.

⁽²⁾ As of July 1, 1989, Santa Barbara County FCWCD transferred certain of its rights under its Water Supply Contract to certain local water purveyors and users within Santa Barbara County. Thereafter, on September 26, 1991, the local water purveyors and users transferred those rights to the Central Coast Water Authority in consideration for its agreement to provide for the delivery of State Water Project water to the local water purveyors and users. Although the Department did not object to these transfers, the Department considers Santa Barbara County FCWCD to be the party to which the Department is obligated under the Water Supply Contract, and the Department did not release Santa Barbara County FCWCD from its Water Supply Contract obligations.

⁽³⁾ Have not signed the Monterey Amendment.

⁽⁴⁾ Totals may not sum due to rounding.

Source: Department of Water Resources, State Water Project Analysis Office

Payment History

The Department has not experienced payment delinquencies or defaults by Contractors that have had a materially adverse effect on the operation or maintenance of the State Water Project, or the ability of the Department to pay its obligations when due. Under the Water Supply Contracts, if a Contractor defaults in payment, the Department may, and under certain conditions is required to, upon six months' notice, suspend water deliveries during the period of default. In accordance with a statutory requirement, each Water Supply Contract requires that whenever the Contractor fails or is unable to raise sufficient funds by other means the Contractor must levy upon all taxable property in the Contractor's service area a tax or assessment sufficient (with other available moneys) to provide for all payments under the Water Supply Contract. (See "CERTAIN LIMITATIONS ON CONTRACTOR REVENUE SOURCES.")

Selected Contractor Financial Information

Relative Contributions of Contractors. The following table lists the three largest Contractors based on projected payments to the Department through the final maturity of the Bonds, these percentages may change over time.

Contractor	Projected Percentage Contribution
The Metropolitan Water District of Southern California.....	41%
Santa Barbara County Flood Control and Water Conservation District/Central Coast Water Authority	13
Kern County Water Agency.....	9
Twenty-six other Contractors.....	37
Total	100%

Metropolitan. The audited financial statements of Metropolitan for the year ended June 30, 2013, can be obtained at <http://www.munios.com>, then searching for keyword "Series AS" and choosing the appropriate link. The audited financial statements of Metropolitan for the year ended June 30, 2014, are expected to be released by Metropolitan prior to the delivery of the Series AS Bonds.

Santa Barbara County FCWCD/Central Coast Water Authority. As of July 1, 1989, Santa Barbara County FCWCD transferred certain of its rights under its Water Supply Contract to certain local water purveyors and users within Santa Barbara County. On September 26, 1991, the local water purveyors and users transferred those rights to the Central Coast Water Authority in consideration for its agreement to provide for the delivery of State Water Project water to the local water purveyors and users. Although the Department did not object to these transfers, the Department considers Santa Barbara County FCWCD to be the party to which the Department is obligated under the Water Supply Contract, and the Department did not release Santa Barbara County FCWCD from its Water Supply Contract obligations. The audited financial statements of Santa Barbara County FCWCD for the year ended June 30, 2014 and the audited financial statements of Central Coast Water Authority for the year ended June 30, 2013, can be obtained at <http://www.munios.com>, then searching for keyword "Series AS" and choosing the appropriate link. The audited financial statements of Central Coast Water Authority for the year ended June 30, 2014, are expected to be released by the Central Coast Water Authority prior to the delivery of the Series AS Bonds.

KCWA. The audited financial statements of KCWA for the year ended June 30, 2013, can be obtained at <http://www.munios.com>, then searching for keyword “Series AS” and choosing the appropriate link.

***Certain Limitations.* The Department has made no independent verification of the data contained in the audited financial statements of any Contractor and makes no representations as to its correctness, completeness, or comparability.**

Contractor Official Statements and Continuing Disclosure Filings. Various contractors periodically file Official Statements and disclosure reports with the Municipal Securities Rulemaking Board (“MSRB”) in connection with their publicly offered debt. Such Official Statements and disclosure reports are available from the MSRB but are not incorporated by reference herein and the Department does not assume any responsibility for the completeness or accuracy thereof.

CERTAIN LIMITATIONS ON CONTRACTOR REVENUE SOURCES

This section describes certain constitutional or statutory provisions that may limit the ability of some or all of the Contractors to levy and collect fees, charges, taxes or assessments.

Article XIII A of the Constitution

An initiative measure approved by the California voters on June 6, 1978 (Proposition 13), added Article XIII A to the California Constitution. Section 1(a) of Article XIII A limits the maximum *ad valorem* taxes on real property to one percent of the “full cash value” of the property, subject to certain exceptions, including *ad valorem* taxes to pay debt service indebtedness approved by voters prior to July 1, 1978. (See “THE WATER SUPPLY CONTRACTS – Obligation to Levy Taxes or Assessments.”) “Full cash value” is defined as the valuation of real property as shown on the 1975-76 tax roll, and thereafter the appraised value of property when purchased, newly constructed or a change in ownership has occurred. The value base of the property may also be increased to reflect the inflation rate, but not to exceed 2 percent per year.

On June 3, 1986, the California voters approved an amendment to Section 1(b) of Article XIII A permitting *ad valorem* taxes or special assessments in excess of the one percent limit in Section 1(a) to pay the interest and redemption charges on any bonded indebtedness for the acquisition or improvement of real property approved on or after July 1, 1978 by two-thirds of the votes cast by the voters voting on the proposition.

Article XIII B of the Constitution

An initiative amendment to the California Constitution (Article XIII B) was approved by the California electorate on November 6, 1979. This amendment establishes limits on certain annual appropriations of state and local government entities. Initially, the limits are based generally on appropriations for the fiscal year 1978-79 with future adjustments permitted for changes in the cost of living, population and certain other factors. The definition of appropriations subject to limitation is stated so as to exclude, among other things, (1) appropriations of proceeds received by a government entity from user fees to the extent such proceeds do not exceed the costs reasonably borne by such entity in providing the product or service, (2) the appropriations of any special district “which did not as of the 1977-78 fiscal year levy an *ad valorem* tax on property in excess of 12 1/2 cents per \$100 of assessed value,” and (3) “appropriations required to pay the cost of interest and redemption charges, including the funding of any reserve or sinking fund required in connection therewith, on indebtedness existing or legally authorized as of January 1, 1979, or a bonded indebtedness thereafter approved . . .” by vote of the

electors of the issuing entity. In addition, the amendment provides that nothing in it “shall be construed to impair the ability of the State or any local government to meet its obligations with respect to existing or future bonded indebtedness.”

Article XIII C and Article XIII D of the Constitution

A substantial portion of the revenues of the Contractors is derived from the collection of charges for water service. In addition, each Contractor has agreed to levy a tax or assessment sufficient to provide for all payments under its Water Supply Contract if it is unable to raise sufficient funds by other means. The Contractors’ ability to collect such charges, and to levy such taxes or assessments, may be limited by the Right to Vote on Taxes Act (“Proposition 218”), an initiative amendment to the California Constitution approved by the California voters in November 1996.

Proposition 218 added Articles XIII C and XIII D to the California Constitution, creating additional requirements for the imposition by most local governments of “general taxes,” “special taxes,” “assessments,” “fees,” and “charges.” Proposition 218 became effective, pursuant to its terms, as of November 6, 1996, although compliance with some of its provisions was deferred until July 1, 1997, and certain of its provisions purport to apply to any tax imposed for general governmental purposes (i.e., “general taxes”) imposed, extended or increased on or after January 1, 1995 and prior to November 6, 1996. Article XIII D imposes substantive and procedural requirements on the imposition, extension or increase of any “fee” or “charge” subject to its provisions. A “fee” or “charge” subject to Article XIII D includes any levy, other than an ad valorem tax, special tax, or assessment, imposed by an agency upon a parcel or upon a person as an incident of property ownership. Article XIII D prohibits, among other things, the imposition of any proposed fee or charge, and, possibly, the increase of any existing fee or charge, in the event written protests against the proposed fee or charge are presented at a required public hearing on the fee or charge by a majority of owners of the parcels upon which the fee or charge is to be imposed. Except for fees and charges for water, sewer and refuse collection services, the approval of a majority of the property owners subject to the fee or charge, or at the option of the agency, by a two-thirds vote of the electorate residing in the affected area, is required within 45 days following the public hearing on any such proposed new or increased fee or charge. The California Supreme Court decisions in Richmond v. Shasta Community Services District, 32 Cal. 4th 409 (2004) (“Richmond”), and Bighorn-Desert View Water Agency vs. Verjil (published July 24, 2006) (“Bighorn”) have clarified some of the uncertainty surrounding the applicability of Section 6 of Article XIII D to service fees and charges. In Richmond, the Shasta Community Services District charged a water connection fee, which included a capacity charge for capital improvements to the water system and a fire suppression charge. The Court held that both the capacity charge and the fire suppression charge were not subject to Article XIII D because a water connection fee is not a property-related fee or charge because it results from the property owner’s voluntary decision to apply for the connection. In both Richmond and Bighorn, however, the Court stated that a fee for ongoing water service through an existing connection is imposed “as an incident of property ownership” within the meaning of Article XIII D, rejecting, in Bighorn, the water agency’s argument that consumption-based water charges are not imposed “as an incident of property ownership” but as a result of the voluntary decisions of customers as to how much water to use.

Article XIII D also provides that “standby charges” are considered “assessments” and must follow the procedures required for “assessments” under Article XIII D and imposes several procedural requirements for the imposition of any assessment, which may include (1) various notice requirements, including the requirement to mail a ballot to owners of the affected property; (2) the substitution of a property owner ballot procedure for the traditional written protest procedure, and providing that “majority protest” exists when ballots (weighted according to proportional financial obligation) submitted in opposition exceed ballots in favor of the assessments; and (3) the requirement that the levying entity

“separate the general benefits from the special benefits conferred on a parcel” of land. Article XIID also precludes standby charges for services that are not immediately available to the parcel being charged.

Article XIID provides that all existing, new or increased assessments are to comply with its provisions beginning July 1, 1997. Existing assessments imposed on or before November 5, 1996, and “imposed exclusively to finance the capital costs or maintenance and operations expenses for [among other things] water” are exempted from some of the provisions of Article XIID applicable to assessments.

Article XIIC extends the people’s initiative power to reduce or repeal existing local taxes, assessments, fees and charges. This extension of the initiative power is not limited by the terms of Article XIIC to fees, taxes, assessment fees and charges imposed after November 6, 1996 and absent other authority could result in retroactive reduction in any existing taxes, assessments, fees or charges. In Bighorn, the Court concluded that under Article XIIC local voters by initiative may reduce a public agency’s water rates and delivery charges. The Court noted, however, that it was not holding that the authorized initiative power is free of all limitations, stating that it was not determining whether the electorate’s initiative power is subject to the public agency’s statutory obligation to set water service charges at a level that will “pay the operating expenses of the agency, ... provide for repairs and depreciation of works, provide a reasonable surplus for improvements, extensions, and enlargements, pay the interest on any bonded debt, and provide a sinking or other fund for the payment of the principal of such debt as it may become due.”

In November 2010, the California voters approved the Supermajority Vote to Pass New Taxes and Fees Act (“Proposition 26”), an initiative amendment to Article XIIC. Proposition 26 amended Article XIIC to add additional restrictions on local agencies’ ability to impose new or increase existing charges. These additional restrictions do not, however, apply to, among other things, “property-related fees imposed in accordance with the provisions of Article XIID,” which includes a fee for ongoing water service.

No assurance may be given that Articles XIIC and XIID will not have a material adverse impact on Contractors’ ability to generate revenues.

Other Initiative Measures

Articles XIIA, XIIB, XIIC and XIID were adopted, and in some cases amended, pursuant to California’s constitutional initiative process. From time to time other initiative measures could be adopted by California voters, placing additional limitations on the ability of the Contractors to increase revenues.

Special Limitations Applicable to Metropolitan

In 1983, the California Legislature placed additional restrictions on the taxing power of Metropolitan. The restrictions reflected the ongoing debates among Metropolitan’s member agencies over whether to continue using property taxes as a major source of revenue or whether to shift to reliance on water rates. The legislation permitted Metropolitan to raise its property tax rate above one percent only under limited circumstances. The rate could be higher in 1983-84, but in 1984-85 and 1985-86, the rate would have to return to its 1982-83 level unless 80 percent of Metropolitan’s board found that a fiscal emergency existed. The bill also required Metropolitan to report to the Legislature regarding its efforts to reduce its reliance on property taxes. Metropolitan reached an agreement among its member agencies for gradually shifting to an increased reliance on water rates and filed its report. In response, the Legislature codified the agreement in SB 1445 in 1984 (Chapter 271, Statutes of 1984), which, among other things,

made several amendments to Metropolitan's organizing Act. One provision provides that commencing with fiscal year 1990-91, any *ad valorem* property tax levied by Metropolitan, other than special annexation tax levies, shall not exceed the composite amount required to pay (1) its general obligation bond debt service, and (2) that portion of its Water Supply Contract payment that is reasonably allocable, as determined by Metropolitan, to the portion of the debt service payment for the Burns-Porter Act bonds that were approved by the State's voters in 1960 and which were used to finance construction of facilities for the benefit of Metropolitan. This statutory tax levy restriction would not apply, however, if Metropolitan's board, following a hearing to consider the issue, should find that a tax in excess of the limitation would be essential to Metropolitan's fiscal integrity.

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Department ("Bond Counsel"), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series AS Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "Code") and is exempt from State of California personal income taxes. Bond Counsel is of the further opinion that interest on the Series AS Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. A complete copy of the proposed form of opinion of Bond Counsel is set forth in APPENDIX F hereto.

To the extent the issue price of any maturity of the Series AS Bonds is less than the amount to be paid at maturity of such Series AS Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Series AS Bonds), the difference constitutes "original issue discount," the accrual of which, to the extent properly allocable to each Beneficial Owner thereof, is treated as interest on the Series AS Bonds which is excluded from gross income for federal income tax purposes and exempt from State of California personal income taxes. For this purpose, the issue price of a particular maturity of the Series AS Bonds is the first price at which a substantial amount of such maturity of the Series AS Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the Series AS Bonds accrues daily over the term to maturity of such Series AS Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Series AS Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Series AS Bonds. Beneficial Owners of the Series AS Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Series AS Bonds with original issue discount, including the treatment of Beneficial Owners who do not purchase such Series AS Bonds in the original offering to the public at the first price at which a substantial amount of such Series AS Bonds is sold to the public.

Series AS Bonds purchased, whether at original issuance or otherwise, for an amount higher than their principal amount payable at maturity (or, in some cases, at their earlier call date) ("Premium Bonds") will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of bonds, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax exempt interest received, and a beneficial owner's basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such beneficial owner. Beneficial owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Series AS Bonds. The Department has made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the Series AS Bonds will not become includable in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the Series AS Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the Series AS Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring), or any other matters coming to Bond Counsel's attention after the date of issuance of the Series AS Bonds may adversely affect the value of, or the tax status of interest on, the Series AS Bonds. Accordingly, the opinion of Bond Counsel is not intended to, and may not, be relied upon in connection with any such actions, events or matters.

Although Bond Counsel is of the opinion that interest on the Series AS Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the accrual or receipt of amounts treated as interest on, the Series AS Bonds may otherwise affect a beneficial owner's federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the beneficial owner or the beneficial owner's other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

Current and future legislative proposals, if enacted into law, clarification of the Code or court decisions may cause interest on the Series AS Bonds to be subject, directly or indirectly, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent beneficial owners from realizing the full current benefit of the tax status of such interest. For example, Representative Dave Camp, Chair of the House Ways and Means Committee, released draft legislation that would subject interest on the Bonds to a federal income tax at an effective rate of 10% or more for individuals, trusts, and estates in the highest tax bracket, and the Obama Administration proposed legislation that would limit the exclusion from gross income of interest on the Bonds to some extent for high-income individuals. The introduction or enactment of any such legislative proposals, clarification of the Code or court decisions may also affect, perhaps significantly, the market price for, or marketability of, the Series AS Bonds. Prospective purchasers of the Series AS Bonds should consult their own tax advisors regarding any pending or proposed federal or state tax legislation, regulations or litigation, and regarding the impact of future legislation, regulations or litigation, as to which Bond Counsel expresses no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel's judgment as to the proper treatment of the Series AS Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the Department or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The Department has covenanted, however, to comply with the requirements of the Code.

Unless separately engaged, Bond Counsel is not obligated to defend the Department or the beneficial owners regarding the tax-exempt status of the Series AS Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the Department and their appointed counsel, including the beneficial owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions with

which the Department legitimately disagrees may not be practicable. Any action of the IRS, including but not limited to selection of the Series AS Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the Series AS Bonds, and may cause the Department or the beneficial owners to incur significant expense.

RATINGS

Moody's Investors Service, Inc. ("Moody's"), and Standard & Poor's Rating Services, a Standard & Poor's Financial Services LLC business ("Standard & Poor's"), have assigned ratings of "Aa1" and "AAA," respectively, to the Series AS Bonds. Such ratings are based in part upon information provided by the Department. Each rating reflects only the views of the applicable rating agency, and an explanation of the significance of such rating may be obtained only from such rating agency. Such ratings are not a recommendation to buy, sell or hold the Series AS Bonds. There can be no assurance that either such rating will continue for any given period of time or that it will not be revised downward or withdrawn entirely if, in the judgment of the applicable rating agency, circumstances so warrant. Any such downward revision or withdrawal of any rating may have an adverse effect on the marketability or market price of the Series AS Bonds. The Department undertakes no responsibility to maintain its current credit ratings on the Bonds or to oppose any downward revision, suspension or withdrawal.

FINANCIAL ADVISOR

Montague DeRose and Associates, LLC is serving as financial advisor to the Department in connection with the issuance of the Series AS Bonds.

APPROVAL OF LEGAL PROCEEDINGS

The issuance of the Series AS Bonds is subject to the delivery on the issuance date of the approving opinions of The Honorable Kamala D. Harris, the Attorney General of the State, and Orrick, Herrington & Sutcliffe LLP, Bond Counsel. The proposed forms of such opinions are set forth in APPENDIX E and APPENDIX F, respectively to this Official Statement. Certain matters are also subject to the approval of Stradling, Yocca, Carlson & Rauth, counsel to the Underwriters.

FINANCIAL STATEMENTS

The financial statements of the State Water Resources Development System at June 30, 2013, and June 30, 2012, and for the years then ended, appearing in APPENDIX B to this Official Statement have been audited by Macias, Gini & O'Connell LLP, independent auditors (the "Auditor"), as set forth in the report of Macias, Gini & O'Connell LLP appearing in APPENDIX B.

The State Water Resources Development System includes the State Water Project, the Davis-Grunsky Act Program and the San Joaquin Drainage Program.

VERIFICATION

Causey Demgen & Moore P.C., a firm of independent public accountants, will deliver to the Department its verification report indicating that it has verified, in accordance with attestation standards established by the American Institute of Certified Public Accountants, the mathematical accuracy of (a) the mathematical computations of the adequacy of the amounts deposited or to be deposited with the Treasurer in the Series AS Escrow Account to pay the redemption price of and interest on the Series AS Refunded Bonds, when due and (b) the mathematical computations of yield used by Bond Counsel to

support its opinion that interest on the Series AS Bonds will be excluded from gross income for federal income tax purposes. (See “PLAN OF REFUNDING.”)

The verification to be performed by Causey Demgen & Moore P.C. will be solely based upon data, information and documents provided to Causey Demgen & Moore P.C. by the Department and its representatives. Causey Demgen & Moore P.C. has restricted and will restrict, as applicable, its procedures for recalculating the computations provided by the Department and its representatives and will not evaluate or examine the assumptions or information used in the computations.

UNDERWRITING

The Series AS Bonds are being purchased by an underwriting group, represented by Morgan Stanley & Co. LLC and Samuel A. Ramirez & Company, Inc. (referred to herein as the “Underwriters”), from the Treasurer, who is authorized pursuant to the Act to sell the Series AS Bonds on behalf of the Department. The Underwriters have agreed to purchase the Series AS Bonds at a price of \$785,313,199.51, representing the principal amount of the Series AS Bonds, plus original issue premium in the amount of \$141,613,096.30, less an Underwriters’ discount of \$2,094,896.79. The purchase contract pursuant to which the Series AS Bonds are being sold provides that the Underwriters will purchase all of the Series AS Bonds, if any Series AS Bonds are purchased, the obligation to make such purchase is subject to certain terms and conditions set forth in the purchase contract, the approval of certain legal matters by counsel and certain other conditions.

The Underwriters have certified the reoffering prices or yields set forth on the inside cover hereof. The Department takes no responsibility for the accuracy of these prices or yields. The Underwriters may offer and sell the Series AS Bonds to certain dealers and others at prices lower than the offering prices stated on the inside cover page. The offering prices may be changed from time to time by the Underwriters.

Several of the Underwriters have provided letters to the State Treasurer relating to their retail distribution practices for inclusion in this Official Statement, which letters are set forth herein as APPENDIX H. The Department does not guarantee the accuracy or completeness of the information contained in such letters and the information therein is not to be construed as a representation of the Department or any Underwriter other than the Underwriter providing such representation.

CERTAIN RELATIONSHIPS

The financing of the Water System Project and related activities, including the sale of Bonds, has been made possible, in part, by hiring underwriters, financial advisors, consultants and lawyers to assist and advise the Department. Many of the firms and individuals involved in this effort have prior or ongoing relationships with other governmental entities (including Contractors), utilities and other businesses that contract or compete with the Department or contract with the State and other State agencies or that may do so in the future. The Department has required disclosure of, and has taken into account, these relationships and has determined it to be in the best interests of the Department to continue to work with these firms and individuals.

In addition, in the ordinary course of sales, trading, brokerage and financing activities, certain of the underwriters may at any time hold long or short positions, and may trade or otherwise effect transactions, for their own accounts or the accounts of customers, in debt or equity securities or senior loans, as applicable, of the Department, the State, other governmental entities and utilities. In connection with these activities and the provision of other services, certain of the underwriters may be or become creditors of such entities. In addition, many of the Underwriters, or their affiliates, currently serve as

remarketing agents or providers of credit enhancement or liquidity facilities for variable rate obligations issued by, or as interest rate swap providers to, the Department, the State, other State agencies, other governmental entities and utilities.

LITIGATION

No litigation is pending or threatened concerning the validity or enforceability of the Series AS Bonds. Except as described above under “WATER SUPPLY CONTRACT RELATED LITIGATION – Monterey Amendment Litigation,” no litigation is pending or threatened concerning the validity or enforceability of the Water Supply Contracts.

At any given time, including the present, there are a number of civil actions pending against the Department, which could, if determined adversely to the Department, affect the Department’s expenditures and in some cases, its revenues. However, based in part upon discussions with the Attorney General, the Department does not believe there are any pending actions that are likely to have a material adverse effect on the Department’s ability to pay principal of, and premium, if any, and interest on the Bonds when due.

CONTINUING DISCLOSURE

The Department will covenant for the benefit of the holders and beneficial owners of the Series AS Bonds to provide certain financial information and operating data relating to the Department by not later than 270 days following the end of the Department’s fiscal year (which fiscal year as of the date hereof ends June 30) (the “Annual Report”), commencing with the report containing 2013-2014 Fiscal Year financial information, and to provide notices of the occurrence of certain enumerated events (“Event Notices”). These covenants have been made in order to assist the Underwriters in complying with Rule 15c2-12 of the Securities and Exchange Commission. Unless otherwise directed by the MSRB or the Securities and Exchange Commission, the Annual Report and Event Notices will be filed by the Department with the MSRB through its Electronic Municipal Market Access website. The specific nature of the information to be contained in the Annual Report or the Event Notices and certain other terms of this continuing disclosure obligation is summarized in APPENDIX D – “Summary of Continuing Disclosure Certificate.” Pursuant to the Resolution, failure of the Department to comply with its obligations under the Continuing Disclosure Certificate (as supplemented in connection with the issuance of the Series AS Bonds, the “Continuing Disclosure Certificate”) will not be considered an event of default under the Resolution. However, the State Treasurer, any holder or beneficial owner may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the Department to comply with its obligations under the Continuing Disclosure Certificate.

In the past five years the Department has always filed each annual report on a timely basis as required by its continuing disclosure undertakings. In the past five years the Department, has also complied with its undertakings to file notices of certain events as required by its continuing disclosure undertakings, provided, however, the Department cannot find evidence that it filed notices of certain rating changes on its Power Supply Revenue Bonds due to the change in ratings of a bond insurer in 2009 and 2010 or that it filed notice of an upgrade in the rating on the Bonds in 2010 as a result of the recalibration by Moody’s of its municipal rating scale.

MISCELLANEOUS

The Appendices to this Official Statement are integral parts of this Official Statement and must be read together with all other parts of this Official Statement.

All references to the Bonds, the Resolution, any supplemental resolution, the Water Supply Contracts, the Continuing Disclosure Certificate and any provision of law are subject to the terms and provisions of each such document or law and do not purport to be complete statements of the terms and provisions thereof, and reference to the complete texts is made for further information in connection therewith. Copies of the Resolution, the Water Supply Contracts and the Continuing Disclosure Certificate are on file at the offices of the Department and the State Treasurer. Statements herein involving matters of opinion, whether or not specifically so designated, are intended merely as such and not as representations of fact.

The Department maintains a website at <http://www.water.ca.gov>. The information contained in such website is not incorporated herein by reference and is not intended to be relied upon in making an investment decision with respect to the Series AS Bonds.

The agreement of the Department is fully set forth in the Resolution, and this Official Statement is not to be construed as, and is not, a contract with the purchasers of the Series AS Bonds.

APPENDIX A

ESTIMATED DIRECT AND OVERLAPPING DEBT OF CERTAIN CONTRACTORS

The data presented in this Appendix summarize certain information regarding taxes and tax-supported debt outstanding within the service territory of each of the three Contractors that are expected to provide the largest amounts of Revenues for payment of the Bonds. These three Contractors and the expected percentage contribution of each to such Revenues over the term of the Bonds are as follows (these percentages may change over time).

Contractor	Percentage Contribution
The Metropolitan Water District of Southern California	41%
Santa Barbara County Flood Control and Water Conservation District/Central Coast Water Authority*	13
Kern County Water Agency	9
Twenty-six other Contractors	37
Total	<u>100%</u>

* As of July 1, 1989, Santa Barbara County FCWCD transferred certain of its rights under its Water Supply Contract to certain local water purveyors and users within Santa Barbara County. Thereafter, on September 26, 1991, the local water purveyors and users transferred those rights to the Central Coast Water Authority in consideration for its agreement to provide for the delivery of State Water Project water to the local water purveyors and users. Although the Department did not object to these transfers, the Department considers Santa Barbara County FCWCD to be the party to which the Department is obligated under the Water Supply Contract, and the Department did not release Santa Barbara County FCWCD from its Water Supply Contract obligations.

The Department has made no independent verification of the data contained in this Appendix and makes no representations as to its correctness, completeness, or comparability.

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

ESTIMATED DIRECT AND OVERLAPPING BONDED DEBT

(unaudited)

2013-14 Assessed Valuation: \$2,184,260,562,787

<u>OVERLAPPING TAX AND ASSESSMENT DEBT:</u>	<u>% Applicable</u>	<u>Debt 9/1/14</u>
Los Angeles County Flood Control District	94.946%	\$ 16,596,561
Community College Districts	Various	9,237,801,374
Los Angeles Unified School District	99.623	10,309,725,250
San Diego Unified School District	99.952	2,270,533,102
Other Unified School Districts	Various	9,443,323,403
High School and School Districts	Various	4,195,294,052
City of Los Angeles	99.997	887,708,368
Other Cities	Various	334,826,319
Irvine Ranch Water District Improvement Districts	99.999-100.	517,498,786
Santa Margarita Water District Improvement Districts	100.	119,385,000
Other Water Districts	Various	56,494,221
Other Special Districts	Various	675,439,821
Community Facilities Districts	Various	6,645,474,346
1915 Act Bonds and Other Special Assessment District Bonds	Various	<u>1,365,585,402</u>
TOTAL OVERLAPPING TAX AND ASSESSMENT DEBT		\$46,075,686,005

METROPOLITAN WATER DISTRICT TOTAL DIRECT DEBT **\$ 132,275,000**

TOTAL DIRECT AND OVERLAPPING TAX AND ASSESSMENT DEBT \$46,207,961,005

<u>OVERLAPPING GENERAL FUND DEBT:</u>		
Los Angeles County Obligations	93.091%	\$ 1,672,104,648
Riverside County Obligations	64.049	659,584,233
San Bernardino County Obligations	49.675	511,832,177
San Diego County Obligations	96.600	1,041,761,139
Other Counties Obligations	Various	473,353,613
City of Anaheim General Fund Obligations	99.827	705,270,233
City of Long Beach General Fund Obligations and Pension Obligation Bonds	100.	211,550,000
City of Los Angeles General Fund and Judgment Obligations	99.997	1,687,762,253
City of Pasadena General Fund and Pension Obligation Bonds	100.	608,871,382
City of San Diego General Fund Obligations	99.939	543,942,992
Other City General Fund Obligations	Various	2,828,704,194
Water District General Fund Obligations	Various	130,602,858
Los Angeles Unified School District Certificates of Participation	99.623	363,164,346
Other School District General Fund Obligations	Various	1,849,505,178
Other Special District General Fund Obligations	Various	<u>197,492,430</u>
TOTAL GROSS OVERLAPPING GENERAL FUND DEBT		\$13,485,501,676
Less: Obligations supported from other revenue sources		<u>1,280,002,979</u>
TOTAL NET OVERLAPPING GENERAL FUND DEBT		\$12,205,498,697

OVERLAPPING TAX INCREMENT DEBT \$ 9,104,232,916

GROSS COMBINED TOTAL DEBT \$68,797,695,597 ⁽¹⁾

NET COMBINED TOTAL DEBT \$67,517,692,618

⁽¹⁾ Debt instruments included are general obligation bonds, lease revenue bonds and certificates of participation (when supported by the general fund), pension obligation bonds, 1915 Act special assessment bonds and Mello-Roos Act special assessment bonds. Excluded are enterprise revenue bonds, mortgage revenue bonds, tax and revenue anticipation notes and non-bonded capital lease obligations. Qualified Zone Academy Bonds are included based on principal due at maturity.

Ratios to 2013-14 Assessed Valuation:

Direct Debt (\$132,275,000)	0.01%
Total Direct and Overlapping Tax and Assessment Debt.....	2.12%
Gross Combined Total Debt.....	3.15%
Net Combined Total Debt	3.09%

Ratios to Redevelopment Incremental Valuation (\$281,465,454,185):

Total Overlapping Tax Increment Debt.....	3.23%
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**METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
ESTIMATED DIRECT AND OVERLAPPING BONDED DEBT
(unaudited)**

Fiscal Year Ended 6/30	Assessed Valuation (1)	Tax on Secured Property (2)	Delinquencies at June 30		Tax Rate Per \$100 Assessed Valuation		
			Amount	Percent	Agency Total Rate (3)	Typical Total Rate (6)	
1994	\$ 802,129,610,162	\$59,612,366	\$3,412,019	5.72%	(5)	0.0089	1.037135
1995	807,661,342,152	55,677,215	2,333,451	4.30	(5)	0.0089	1.046181
1996	802,593,757,003	56,452,511	3,837,697	6.80	(5)	0.0089	1.053047
1997	804,045,644,470	(4)	(4)	(4)	(4)	0.0089	1.051802
1998	817,424,957,700	(4)	(4)	(4)	(4)	0.0089	1.055796
1999	851,898,186,329	(4)	(4)	(4)	(4)	0.0089	1.067214
2000	910,809,885,402	(4)	(4)	(4)	(4)	0.0089	1.074728
2001	980,279,077,736	(4)	(4)	(4)	(4)	0.0088	1.078822
2002	1,169,293,222,451	(4)	(4)	(4)	(4)	0.0077	1.114077
2003	1,258,093,521,782	(4)	(4)	(4)	(4)	0.0067	1.102497
2004	1,359,534,425,177	(4)	(4)	(4)	(4)	0.0061	1.155130
2005	1,478,635,379,913	(4)	(4)	(4)	(4)	0.0058	1.169638
2006	1,643,013,823,543	(4)	(4)	(4)	(4)	0.0052	1.155967
2007	1,839,880,963,698	(4)	(4)	(4)	(4)	0.0047	1.179045
2008	2,015,721,475,188	(4)	(4)	(4)	(4)	0.0045	1.174687
2009	2,120,944,531,740	(4)	(4)	(4)	(4)	0.0043	1.189738
2010	2,081,864,775,527	(4)	(4)	(4)	(4)	0.0043	1.220441
2011	2,049,887,037,949	(4)	(4)	(4)	(4)	0.0037	1.269859
2012	2,068,668,852,729	(4)	(4)	(4)	(4)	0.0037	1.245849
2013	2,097,369,921,305 (7)	(4)	(4)	(4)	(4)	0.0035	1.265550
2014	2,184,260,562,787	(4)	(4)	(4)	(4)	0.0035	1.224234

Direct and Overlapping Bonded Debt at September 1, 2014:

Total Gross Direct Debt	\$ 132,275,000
Less: Self-supporting Debt	0
Total Net Direct Debt	\$ 132,275,000
Total Overlapping Tax and Assessment Debt	\$46,075,686,005
Direct and Overlapping Tax and Assessment Debt	\$46,207,961,005
Total Gross Overlapping General Fund Obligation Debt	\$13,485,501,676
Less: Self-supporting Debt	1,280,002,979
Total Net Overlapping General Fund Obligation Debt	\$12,205,498,697
Overlapping Tax Increment Debt	\$ 9,104,232,916
Gross Direct and Overlapping Bonded Debt	\$68,797,695,597
Net Direct and Overlapping Bonded Debt	\$67,517,692,618

Ratios to Assessed Valuation at September 1, 2014:

Gross Direct Debt	0.01%
Net Direct Debt	0.01%
Direct and Overlapping Tax and Assessment Debt	2.12%
Total Gross Direct and Overlapping Bonded Debt	3.15%
Total Net Direct and Overlapping Bonded Debt	3.09%

- (1) Assessed Valuations are based on 100% of cash value beginning in 1981-82, rather than 25% as in previous years. The assessed valuations include state-reimbursable exemptions. Beginning in 1988-89, assessed valuations exclude unitary utility valuations.
- (2) Excludes tax levy on inventories and other unsecured property.
- (3) Base rate for all member areas. Some areas added after formation of the District pay higher rates.
- (4) Information unavailable.
- (5) Los Angeles County portion only.
- (6) Los Angeles County TRA 67.
- (7) Excludes Orange County November 2012 unsecured adjustments.

**SANTA BARBARA COUNTY FLOOD
CONTROL AND WATER CONSERVATION DISTRICT
OVERLAPPING INDEBTEDNESS
(unaudited)**

Fiscal Year Ended 6/30	Assessed Valuation (1)	Tax on Secured Property (2)	Delinquencies at June 30		Tax Rate Per \$100 Assessed Valuation	
			Amount	Percent	Agency Total Rate	Typical Total Rate
1994	\$23,565,169,448	\$244,026,174	\$10,006,296	4.10%	0.00000	1.00156
1995	23,261,622,373	247,611,391	6,653,174	2.69	0.00000	1.00102
1996	23,727,401,813	254,306,422	5,249,677	2.06	0.00000	1.00761
1997	24,437,672,493	263,655,875	4,229,750	1.60	0.00000	1.01223
1998	25,413,740,531	272,955,441	3,252,689	1.19	0.00000	1.01106
1999	26,929,428,510	292,586,142	2,482,863	0.85	0.00000	1.02221
2000	28,506,012,483	312,186,449	4,545,263	1.46	0.00000	1.01919
2001	30,811,725,758	336,579,195	6,194,044	1.84	0.00000	1.02724
2002	33,470,431,216	325,958,442	4,097,562	1.26	0.00000	1.02799
2003	35,986,575,550	348,404,287	4,327,765	1.24	0.00000	1.02707
2004	38,619,690,313	378,733,525	3,827,763	1.01	0.00000	1.02530
2005	42,010,491,267	412,156,061	4,490,277	1.09	0.00000	1.02086
2006	46,430,715,568	459,630,599	5,978,796	1.30	0.00000	1.02586
2007	51,053,483,690	508,780,407	10,760,629	2.11	0.00000	1.02631
2008	54,591,882,970	547,037,318	13,322,133	2.44	0.00000	1.02633
2009	56,957,844,751	570,319,442	15,942,615	2.80	0.00000	1.03483
2010	57,102,686,939	573,825,003	13,723,941	2.39	0.00000	1.03496
2011	57,601,688,658	575,911,027	9,363,054	1.63	0.00000	1.03496
2012	58,359,033,685	582,738,827	7,131,251	1.22	0.00000	1.03619
2013	58,837,930,366	590,636,407	5,574,662	0.94	0.00000	1.03969
2014	61,284,526,961	(3)	(3)	(3)	0.00000	1.04840

Direct and Overlapping Bonded Debt at September 1, 2014:

Total Gross Direct Debt	\$ 0
Less: Supported Debt	<u>0</u>
Total Net Direct Debt	\$ 0
Total Gross Overlapping Tax and Assessment Debt	\$649,582,883
Less: Supported Debt	<u>0</u>
Total Net Overlapping Tax and Assessment Debt	\$649,582,883
Total Gross Overlapping General Fund Debt	\$174,738,747
Less: Supported Debt	<u>54,757,516</u>
Total Net Overlapping General Fund Debt	\$119,981,231
Total Gross Overlapping Tax Increment Debt	\$ 69,655,000
Less: Supported Debt	<u>0</u>
Total Net Overlapping Tax Increment Debt	\$ 69,655,000
Total Gross Direct and Overlapping Bonded Debt	\$893,976,630
Less: Self-supporting Debt	<u>54,757,516</u>
Total Net Direct and Overlapping Bonded Debt	\$839,219,114

Ratio to Assessed Valuation at September 1, 2014:

Gross Direct Debt	0.00%
Net Direct Debt	0.00%
Total Gross Overlapping Tax and Assessment Debt	1.06%
Total Net Overlapping Tax and Assessment Debt	1.06%
Gross Direct and Overlapping Bonded Debt	1.46%
Net Direct and Overlapping Bonded Debt	1.37%

- (1) The assessed valuations include state-reimbursable exemptions and exclude redevelopment incremental valuations. Beginning in 1988-89, assessed valuations exclude unitary utility valuations.
- (2) Excludes tax levy on inventories and other unsecured property.
- (3) Information to be available in late September.

**KERN COUNTY WATER AGENCY
OVERLAPPING INDEBTEDNESS
(unaudited)**

Fiscal Year Ended 6/30	Assessed Valuation (1)	Tax on Secured Property (2)	Delinquencies at June 30		Tax Rate Per \$100 Assessed Valuation		
			Amount	Percent	Agency Rate	City of Bakersfield Total Rate	Elk Hills School District
1994	\$32,986,554,039	\$12,246,716	\$364,041	2.97%	0.066719	1.171248	1.020210
1995	30,100,052,112	9,370,510	287,927	3.07	0.070116	1.135179	1.019195
1996	30,538,512,132	12,656,809	338,224	2.67	0.095807	1.173827	1.020669
1997	31,943,215,222	13,283,378	395,321	2.98	0.091633	1.179749	1.022585
1998	34,411,749,796	12,984,313	480,525	3.70	0.091601	1.172489	1.019745
1999	32,692,348,290	13,035,390	282,929	2.17	0.089041	1.139540	1.016470
2000	36,368,798,648	(3)	(3)	(3)	0.088270	1.162026	1.035082
2001	38,813,931,812	15,981,366	295,032	1.85	0.077322	1.157759	1.017135
2002	41,429,323,346	15,210,702	339,798	2.23	0.061936	1.117621	1.015612
2003	39,976,729,738	15,776,379	476,821	3.02	0.060665	1.160526	1.019332
2004	42,165,212,745	18,525,332	(3)	(3)	0.063662	1.146391	1.021406
2005	45,443,236,748	16,054,006	237,483	1.48	0.063200	1.156496	1.056077
2006	52,596,138,408	13,726,652	258,314	1.88	0.047579	1.133705	1.055929
2007	64,149,863,242	12,223,309	384,215	3.14	0.038184	1.122182	1.047846
2008	71,491,760,384	18,521,313	802,472	4.33	0.053401	1.157296	1.050210
2009	75,766,431,779	17,059,057	572,984	3.36	0.052517	1.151185	1.054710
2010	70,423,049,669	19,500,828	565,663	2.90	0.064063	1.180167	1.064484
2011	74,597,201,953	17,863,779	345,942	1.94	0.058402	1.176436	1.053897
2012	76,240,534,603	25,718,178	379,982	1.48	0.074783	1.191102	1.054265
2013	81,254,773,400	18,041,862	234,670	1.30	0.057330	1.174290	1.043923
2014	81,080,979,985	21,461,367	244,116	1.14	0.062029	1.144662	1.073345

Direct and Overlapping Bonded Debt at September 1, 2014:

Total Gross Direct Debt	\$ 0
Less: Supported Debt	0
Total Net Direct Debt	\$ 0
Total Gross Overlapping Tax and Assessment Debt	\$1,115,431,771
Less: Supported Debt	1,880,000
Total Net Overlapping Tax and Assessment Debt	\$1,113,551,771
Total Gross Overlapping General Fund Debt	\$ 843,174,112
Less: Self-supporting Debt	0
Total Net Overlapping General Fund Debt	\$ 843,174,112
Total Gross Overlapping Tax Increment Debt	\$ 88,405,000
Less: Supported Debt	0
Total Net Overlapping Tax Increment Debt	\$ 88,405,000
Gross Direct and Overlapping Bonded Debt	\$2,047,010,883
Net Direct and Overlapping Bonded Debt	\$2,045,130,883

Ratios to Assessed Valuation at September 1, 2014:

Gross Direct Debt	0.00%
Net Direct Debt	0.00%
Gross Direct and Overlapping Tax and Assessment Debt	1.38%
Net Direct and Overlapping Tax And Assessment Debt	1.37%
Gross Direct and Overlapping Bonded Debt	2.52%
Net Direct and Overlapping Bonded Debt	2.52%

- (1) Assessed Valuations are based on 100% of cash value beginning in 1981-82, rather than 25% as in previous years. The assessed valuations include state-reimbursable exemptions and exclude redevelopment incremental valuations. Beginning in 1988-89, assessed valuations exclude unitary utility valuations.
- (2) Excludes tax levy on inventories and other unsecured property.
- (3) Information unavailable.

APPENDIX B

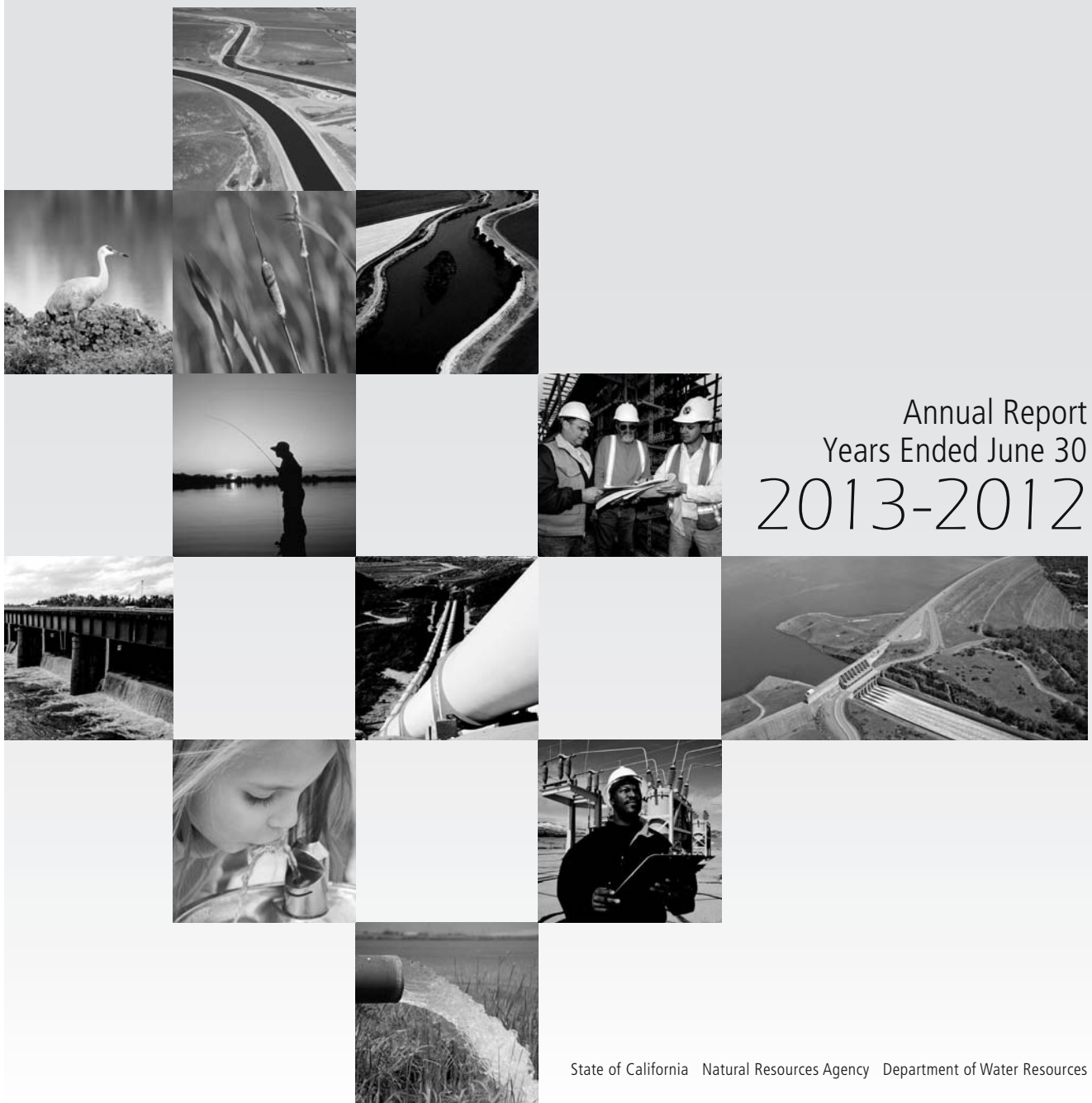
**AUDITED FINANCIAL STATEMENT
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

**STATE WATER RESOURCES
DEVELOPMENT SYSTEM**

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STATE WATER RESOURCES DEVELOPMENT SYSTEM

Financial Statements and Supplementary Information



Annual Report
Years Ended June 30
2013-2012

Cover photos, top to bottom, left to right:

(1) California Aqueduct and Delta Mendota Canal intertie, (2) Sandhill Crane in the Delta, (3) Cattails grow in the wetlands, (4) Delta, (5) Fly fishing in Oroville, (6) DWR personnel look at plans, (7) Sacramento weir, (8) Devil Canyon Power Plant penstocks, (9) Lake Oroville, (10) Girl drinking from water fountain, (11) DWR employee at Oso Pumping Plant, (12) Agricultural irrigation near the Yuba River

Cover design by DWR Payables Office & DWR Graphic Services

STATE OF CALIFORNIA
Edmund G. Brown Jr., Governor

NATURAL RESOURCES AGENCY
John Laird, Secretary for Natural Resources

DEPARTMENT OF WATER RESOURCES
Mark W. Cowin, Director

Carl Torgersen
Deputy Director

Laura King Moon
Chief Deputy Director

Kathie Kishaba
Deputy Director

Paul Helliker
Deputy Director

John Pacheco
Acting Deputy Director

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Cathy Crothers
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Division of Fiscal Services
Perla M. Netto-Brown, Chief

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State Water Resources Development System

**Financial Statements and
Supplementary Information**

For the years ended June 30, 2013 and 2012

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State Water Resources Development System

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INDEPENDENT AUDITOR'S REPORT

To the Director of the State of California
Department of Water Resources

We have audited the accompanying financial statements of the State Water Resources Development System (System), as of and for the fiscal years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2013 and June 30, 2012, and the changes in its financial position and its cash flows for the fiscal years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 14 to the financial statements, the System adopted the provisions of Governmental Accounting Standards Board (GASB) Statement Nos. 60 – 65. In connection with the implementation of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, the System has reclassified certain amounts previously reported as assets and liabilities to deferred outflows of resources and deferred inflows of resources.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. The supplementary information as listed in the table of contents is for purposes of additional analysis and is not a required part of the basic financial statements.

The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Macias Jini & O'Connell LLP

Sacramento, California
December 30, 2013

State Water Resources Development System Management's Discussion and Analysis (Unaudited) For the years ended June 30, 2013 and 2012

Management's Discussion and Analysis (Required Supplementary Information)

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify any significant changes in the financial position of the State Water Resources Development System (the System), which is administered by the California Department of Water Resources (DWR). Readers are encouraged to consider the information presented in conjunction with the financial statements as a whole, which follow Management's Discussion and Analysis. This discussion and analysis and the financial statements do not relate to DWR's other governmental and proprietary funds. The System includes the State Water Project (SWP), the Davis-Grunsky Act Program and the San Joaquin Drainage Implementation Program.

The SWP encompasses a complex of dams, reservoirs, pumping plants, power plants, aqueducts and pipelines owned and operated by the State of California. The SWP was developed in order to deliver water to areas of need throughout the State for domestic, industrial and agricultural purposes, as well as to provide flood control, recreation, fish and wildlife enhancement, hydroelectric power and other benefits. DWR is responsible for the planning, construction and operation of the SWP. The construction program commenced in 1957 and approximately 700 miles of the System have been completed. The System has entered into long-term water supply contracts with 29 customers; known as the "Water Contractors," in order to recover substantially all System costs. The Water Contractors may request up to maximum annual amounts totaling 4,172,786 acre-feet of water from the System. This maximum does not assure delivery of that amount of water, but rather provides the basis for proportional allocation of available supplies among the Water Contractors.

Portions of the SWP system consist of facilities developed and used jointly with the Federal Central Valley Water Project (CVP) operated by the U.S. Bureau of Reclamation (USBR). In addition, both projects have primary sources of water north of the Sacramento-San Joaquin Delta (Delta), transport water across the Delta and draw water from the southern edge of the Delta. The CVP, like the SWP, provides water for irrigation in the Central Valley, urban water supply, water quality, flood control, power, recreation, and fish and wildlife enhancement. Costs for the jointly developed facilities are shared approximately 55 percent State and 45 percent Federal. In 1986, the System and USBR entered into a Coordinated Operation Agreement (COA) under which the SWP and the CVP coordinate operations, including releases from upstream reservoirs and pumping from the Delta. The COA permits increased operational efficiency of both projects, ensures that each project receives an equitable share of available surplus water, and provides for sharing of responsibilities in meeting certain Delta water quality standards.

Financial Highlights

- The System recorded an increase in total assets of \$207 million on total operating revenues of \$1.1 billion. This did not cause an increase in net position as a result of appropriately reflecting the timing differences in the deferral of expenses incurred and the deferral of capital recovery.
- On September 5, 2012, the System issued \$105.9 million of CVP Water System Revenue Bonds Series AL with an average yield on the bonds of 2.33% to refund \$121.9 million of CVP Water System Revenue Bonds Series X and Z.

State Water Resources Development System Management's Discussion and Analysis (Unaudited) For the years ended June 30, 2013 and 2012

- On September 27, 2012, the System issued \$367 million of CVP Water System Revenue Bonds Series AN and AO with an average yield on the bonds of 2.63% to refund \$298.3 million of CVP Water System Revenue Bonds Series AC and AD and \$44.8 million of Water Revenue Commercial Paper Notes Series 1.
- On March 5, 2013, the System issued \$184 million of CVP Water System Revenue Bonds Series AM with an average yield on the bonds of 2.71% to refund \$211.8 million of CVP Water System Revenue Bonds Series Y and AA.
- On March 26, 2013, the System issued \$45.3 million of CVP Water System Revenue Bonds Series AP with an average yield on the bonds of 2.97% to redeem \$47.7 million of Water Revenue Commercial Paper Notes Series 1.
- On June 18, 2013, the System issued \$120.2 million of CVP Water System Revenue Bonds Series AQ with an average yield on the bonds of 3.22% to fund future construction costs for the East Branch Extension Phase I Improvements and East Branch Extension Phase II.

Overview of Financial Statements

Reports Included in Financial Statements

The System is accounted for as an enterprise fund. Enterprise funds account for the acquisition, operation, and maintenance of governmental facilities and services that are entirely or predominantly self-supported by user charges. This financial report consists of three financial statements, prepared on the accrual basis of accounting, with accompanying note disclosures. These financial statements report information using accounting methods similar (although not identical) to those used by private sector companies. The Statements of Net Position include all the assets, liabilities and the deferred outflows and inflows of resources. The Statements of Revenues, Expenses, and Changes in Net Position report all of the revenues and expenses incurred during the fiscal years presented. The Statements of Cash Flows report the cash inflows and outflows classified by operating, investing, noncapital financing and capital and related financing activities during the reporting periods presented. The notes to the financial statements communicate certain information required by generally accepted accounting principles.

State Water Resources Development System Management's Discussion and Analysis (Unaudited) For the years ended June 30, 2013 and 2012

Condensed Statements of Net Position

	2013	2012 *	2011 *	%Change	%Change
		(as restated)	(as restated)	2013-2012	2012-2011
	(amount in thousands)				
Total utility plant	\$ 3,327,965	\$ 3,212,952	\$ 3,201,464	3.6%	0.4%
Other assets	1,836,727	1,760,104	1,722,647	4.4%	2.2%
Total assets	5,164,692	4,973,056	4,924,111	3.9%	1.0%
Total deferred outflows of resources	124,591	57,930	29,260	115.1%	98.0%
Total assets and deferred outflows of resources	<u>\$ 5,289,283</u>	<u>\$ 5,030,986</u>	<u>\$ 4,953,371</u>	<u>5.1%</u>	<u>1.6%</u>
Capitalization:					
Net position:					
Net investment in capital assets	\$ 785,460	\$ 684,025	\$ 554,854	14.8%	23.3%
Restricted	419,968	521,403	650,574	-19.5%	-19.9%
Total net position	1,205,428	1,205,428	1,205,428	0.0%	0.0%
Long-term liabilities	3,148,075	3,054,464	3,132,196	3.1%	-2.5%
Total capitalization	4,353,503	4,259,892	4,337,624	2.2%	-1.8%
Other liabilities	464,344	477,551	410,197	-2.8%	16.4%
Total capitalization and liabilities	4,817,847	4,737,443	4,747,821	1.7%	-0.2%
Total deferred inflows of resources	471,436	293,543	205,550	60.6%	42.8%
Total capitalization, liabilities, and deferred inflows of resources	<u>\$ 5,289,283</u>	<u>\$ 5,030,986</u>	<u>\$ 4,953,371</u>	<u>5.1%</u>	<u>1.6%</u>

Condensed Statements of Revenues, Expenses, and Changes in Net Position

	2013	2012 *	2011 *	%Change	%Change
		(as restated)	(as restated)	2013-2012	2012-2011
	(amount in thousands)				
Operating revenues:					
Water supply	\$ 931,808	\$ 860,891	\$ 874,748	8.2%	-1.6%
Power sales	146,277	148,360	193,154	-1.4%	-23.2%
Federal and State reimbursements	49,110	36,561	28,294	34.3%	29.2%
Total operating revenues	<u>1,127,195</u>	<u>1,045,812</u>	<u>1,096,196</u>	<u>7.8%</u>	<u>-4.6%</u>
Operating Expenses:					
Operations and maintenance expense	545,413	526,402	428,559	3.6%	22.8%
Purchased power expense	258,899	271,377	342,446	-4.6%	-20.8%
Depreciation expense	85,236	87,400	100,257	-2.5%	-12.8%
Operating expenses recovered, net	18,325	67,063	118,325	-72.7%	-43.3%
Total operating expenses	<u>907,873</u>	<u>952,242</u>	<u>989,587</u>	<u>-4.7%</u>	<u>-3.8%</u>
Income from operations	<u>219,322</u>	<u>93,570</u>	<u>106,609</u>	<u>134.4%</u>	<u>-12.2%</u>
Capital revenues recovered (deferred)	(175,005)	43,834	22,812	-499.2%	92.2%
Interest expense	(53,492)	(107,770)	(134,996)	-50.4%	-20.2%
Other (expense) income	9,175	(29,634)	5,575	-131.0%	-631.6%
Change in net position	-	-	-	-	-
Net position, beginning of year, as restated	<u>1,205,428</u>	<u>1,205,428</u>	<u>1,205,428</u>	<u>0.0%</u>	<u>0.0%</u>
Net position, end of year	<u>\$ 1,205,428</u>	<u>\$ 1,205,428</u>	<u>\$ 1,205,428</u>	<u>0.0%</u>	<u>0.0%</u>

* Certain amounts have been reclassified from amounts previously reported to conform with the current year presentation.

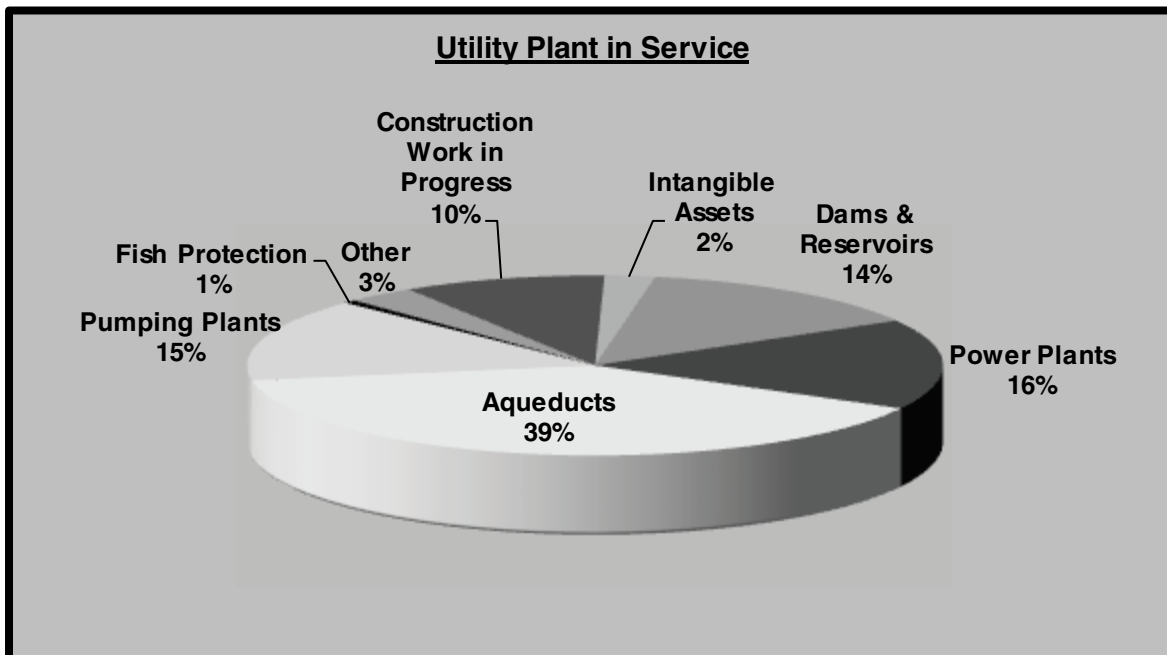
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Assets

Utility Plant

Utility Plant represents the accumulated original costs of labor, materials and indirect costs incurred during the construction of the SWP that are in service to provide water deliveries. The SWP utility includes 33 storage facilities, 23 pumping plants, four generating plants, eight power plants, as well as fish protection facilities, aqueducts, and internally generated intangible assets.

Utility plant in service (UPIS), net of accumulated depreciation decreased by \$5.7 million during fiscal 2013 to a balance of \$2,799 million. Transfers were made from construction work in progress to UPIS of \$65.2 million including Facilities Repair and Improvement of \$25.5 million, East Branch Extension Phase I of \$22.3 million, Fish Restoration Program Agreement – Battle Creek of \$12 million, Reid Gardner of \$2.7 million, South Bay Aqueduct Reach 8 & 9 of \$870 thousand, East Branch Improvement of \$470 thousand, and other Water Systems projects of \$1.4 million in fiscal 2013 in comparison to \$47.2 million in fiscal 2012. The amount of additions and transfers to UPIS in the current year was \$78.9 million compared to \$57.8 million in fiscal 2012. While depreciation expense usually remains fairly constant each year, fiscal 2013 experienced a decrease of \$2.2 million in depreciation expense mainly due to Reid Gardner Power Plant being fully capitalized and depreciated as of June 30, 2013. Depreciation and amortization expense for fiscal 2013 was \$85.2 million compared to fiscal 2012 of \$87.4 million. Ensuing annual depreciation expense should remain relatively constant, as the majority of the System is complete and depreciation is recorded on a straight-line basis over the estimated useful life of the assets, which generally range from 20 to 100 years.



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Construction Work in Progress

Construction work in progress (CWIP) increased by \$120.8 million during the year, which represents a 29.6% increase from fiscal 2012. In fiscal 2012, construction work in progress increased by \$41.1 million, or 11.2% from fiscal 2011. The current year additions to CWIP are attributable to new and on-going projects including East Branch Extension Phase II projects of \$57.8 million, Thermalito assessment cost of \$33.3 million, Facilities Repair and Improvement of \$20.7 million, South Bay Aqueduct Enlargement projects of \$16.6 million, Perris Dam Remediation of \$7.4 million, State Water Project (SWP) Communication System Replacement of \$6.2 million, Reid Gardner of \$2.7 million, South Bay Aqueduct Improvement projects of \$2.6 million, Fish Science Building & Warehouse of \$2.4 million, SWP Protective Relay Replacement projects of \$1.7 million, other Water Systems projects of \$3.4 million, and \$31.1 million of Intangible Assets comprised of internally generated computer software of \$23.3 million for the Centralized Control System Migration Program, legal rights of \$6.7 million for the Fish Restoration Program Agreement – Battle Creek, and \$1.1 million for Federal Energy Regulatory Commission (FERC) relicensing costs. These increases were offset by the transfer of \$65.2 million from construction work in progress to UPIS for projects including Facilities Repair and Improvement of \$25.5 million, East Branch Extension Phase I of \$22.3 million, Fish Restoration Program Agreement – Battle Creek of \$12 million, Reid Gardner of \$2.7 million, South Bay Aqueduct Reach 8 & 9 of \$870 thousand, East Branch Improvement of \$470 thousand, and other Water Systems projects of \$1.4 million.

The increase in fiscal 2012 from 2011 was primarily due to an increase of \$88.3 million for new and on-going projects offset by transfers of \$47.2 million from construction work in progress to UPIS. The increases of new and on-going projects included South Bay Aqueduct Enlargement projects of \$25.8 million, Facilities Repair and Improvement of \$20.9 million, East Branch Extension Phase II projects of \$13.4 million, South Bay Aqueduct Improvement projects of \$12.4 million, South Bay Aqueduct Del Valle Pipeline of \$2.9 million, Edmonston Pump Replacement of \$2.7 million, Oroville Complex Facilities of \$2.4 million, Perris Dam Remediation of \$2.3 million, Delta Fish Survival Improvement of \$1.3 million, and \$4.2 million of Intangible Assets. These increases were offset by transfers to UPIS for projects including Edmonston Pump Replacement of \$39.3 million, Facilities Repair and Improvement of \$7.3 million, South Bay Aqueduct Del Valle Pipeline of \$2.9 million, and a reduction of \$2.3 million for Hyatt Refurbishment.

At June 30, 2013, total construction work in progress comprised of \$204.6 million for the South Bay Aqueduct Enlargement projects, \$199 million of other Water Systems projects, \$94.7 million of East Branch Extension Phase II projects, and \$30.5 million of Intangible Assets.

Restricted Cash and Investments

Restricted cash and cash equivalents decreased by \$6.1 million during fiscal 2013 to a total of \$150.8 million. This compares to a balance of \$156.9 million in fiscal 2012. The current year decrease is attributed to a \$400 thousand decline in the cash for plant replacement and a \$5.7 million decrease in debt service reserve requirement associated with the issuance of bond series AL, AN, AO, AM, AP and AQ, and the refunding of bond series X, Y, Z, AA, AC and AD. Restricted cash for debt service reserve is designated to meet the minimum reserve requirement for the revenue fund. As of June 30, 2013, the total balance in the restricted cash and investments is equal to the minimum balance in the debt service reserve requirement.

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Amounts Recoverable through Future Billing

Amounts recoverable through future billings represent timing differences between expenses incurred by the System and their ultimate recovery from the Water Contractors. Expense recognition is expected to match recovery from the Water Contractors in the future. In fiscal 2013, the amounts recoverable through future billing decreased by \$15.4 million to an ending balance of \$897.4 million compared to \$912.8 million for fiscal 2012.

Other Long-term Assets

Long term loans receivable from local water agencies decreased by \$2.7 million to a total of \$16.5 million. As required by the Davis-Grunsky Act, the System has made loans to local water agencies of which a long-term portion of \$14.4 million remains outstanding at the end of fiscal 2013 compared to an outstanding balance of \$17 million at the end of fiscal 2012. Additionally, \$2.1 million remained outstanding in the Groundwater loan receivable compared to an outstanding balance of \$2.2 million in 2012. Advances to other State Funds represent the System's advance of \$92 million to DWR's internal service fund, which functions as a revolving working capital facility for DWR.

Cash and Cash Equivalents

In fiscal 2013, net cash provided by operations totaled \$379.8 million compared to \$272.4 million in fiscal 2012 for a total net increase to cash and cash equivalents from operations of \$107.4 million. This increase was primarily due to \$79.5 million in decreased payments to suppliers for expenses and \$42.9 million in reductions of aged receivables and timely payments from customers. These increases were offset by \$15.2 million in increases of salaries and wages paid in fiscal 2013.

Receivables

In fiscal 2013, water supply and power billings receivable decreased by \$18.3 million as compared to fiscal 2012. The decrease is primarily due to a decrease of \$17 million in Off-Aqueduct billings and credits, a decrease of \$5.6 million in reduction of aged receivables, a decrease of \$1.3 million of power sales accruals, offset by an increase of \$4.7 million in receivables for the Delta Habitat Conservation and Conveyance Program (DHCCP) billings and other receivables, and an increase of \$900 thousand of miscellaneous revenue accruals.

In fiscal 2012, water supply and power billings receivable increased by \$30.3 million as compared to fiscal 2011. The increase was primarily due to a reduction in refunds and credits issued to water contractors. Other increases included an increase in receivables of \$3.4 million in variable invoices and an increase in power sales accruals of \$3.8 million.

Liabilities

General Obligation Bonds

In addition to the revenue bond obligation described below, a large portion of the SWP was financed by the sale of general obligation bonds of the State pursuant to the provisions of the Burns-Porter Act, which authorized the issuance of \$1,750 million of such bonds for the construction of the SWP. The Burns-Porter Act was adopted by the voters at the State's general election of November 1960. Of that authorization, \$1,582 million (including the entire amount available for construction of the initial components of the SWP) has been issued, of which \$303 million remains outstanding at the end of fiscal 2013 compared to \$362 million at fiscal 2012 and \$421 million at fiscal 2011. The un-issued \$168 million of the authorization is

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available only to provide funds for the construction of certain additional water conservation facilities.

Revenue Bonds

The System has issued 43 series of Water System Revenue Bonds totaling \$7,826 million in the aggregate principal, of which \$2,341 million remains outstanding at the end of fiscal 2013. This compares to outstanding balances of \$2,270 million and \$2,303 million at the end of fiscal year 2012 and 2011, respectively. During the year, the System completed the issuance of CVP Water Systems Revenue Bond Series AL, AM, AN, AO, AP and AQ totaling \$822 million. The majority of the proceeds from the issuance were used to retire portions of the Series X, Y, Z, AA, AC, and AD bonds, pay off all outstanding commercial paper as of the date of issuances, make deposits to the Debt Service Reserve Account, fund interest on a portion of the Series AP and AQ Bonds, and pay costs of issuance.

The System has also issued \$139 million of revenue bonds to finance the Devil Canyon-Castaic power facility. Under the Devil Canyon-Castaic bond resolution, \$68 million is outstanding at the end of fiscal 2013, compared to \$73 million at fiscal 2012 and \$78 million at fiscal 2011.

	<u>2013</u>	<u>2012</u>	<u>2011</u>
	(amounts in thousands)		
CVP revenue bonds par amount	\$ 2,340,905	\$ 2,269,900	\$ 2,302,665
Unamortized bond issuance premiums/(discounts)	<u>185,484</u>	<u>144,892</u>	<u>111,649</u>
Total CVP revenue bonds outstanding	2,526,389	2,414,792	2,414,314
Devil Canyon - Castaic revenue bond par amount	<u>68,070</u>	<u>72,945</u>	<u>77,540</u>
Total revenue bonds outstanding	2,594,459	2,487,737	2,491,854
Less current maturities	<u>(114,775)</u>	<u>(124,155)</u>	<u>(116,150)</u>
Total long-term portion	<u>\$ 2,479,684</u>	<u>\$ 2,363,582</u>	<u>\$ 2,375,704</u>

Pooled Money Investment Loan

The System applied for and received a loan from the Pooled Money Investment Account (PMIA) pursuant to Government Code section 16313 for \$29.6 million. The proceeds of the loan were used to establish escrow accounts that defease certain Water System Revenue Bonds that financed recreation, fish, and wildlife enhancement related costs of the acquisition and construction of the System. The loan is to be repaid with surplus revenues of the System made available under Water Code section 12937(b) (4). DWR executed the Pooled Money Investment Board Loan on March 26, 2008. The loan agreement requires minimum quarterly payments of \$1 million on the first day of every March, June, September and December; the first payment was made on September 1, 2008. Interest is computed on the unpaid principal balance of the loan at the Variable Rate on the basis of a 360-day year or twelve 30-day months and the number of days elapsed. The Variable Rate means (a) for the period from the date of the Loan Agreement, March 26, 2008, through and including the day before the first Reset Date (March 25, 2009), five percent per annum, and (b) for each Renewal Period thereafter, the greater of (i) five percent per annum, or (ii) the last available daily rate of return by the PMIA on the day before the Reset Date on which such Renewal Period commences. In fiscal year 2013, the outstanding balance decreased from \$18.1 million to \$14.9 million due to \$3.2 million of principal payments made during fiscal year 2013. In fiscal 2012, the outstanding balance

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decreased from \$21.1 million to \$18.1 million due to \$3 million of principal payments made during fiscal 2012.

Postemployment Benefits Other than Pensions

The Postemployment Benefits Other than Pensions (OPEB) increased by \$22.5 million to a net OPEB obligation ending balance of \$140.4 million in fiscal 2013 due to the difference between the Annual Required Contribution (ARC) to fully fund the obligation as calculated per GASB 45 requirements of \$34.6 million and the actual contribution charged by the California Department of Finance through pro rata charges of \$12.1 million. The \$22.5 million increase for fiscal 2013 and \$20 million increase in fiscal 2012 reflect the System's under funding of the ARC.

Other Long-Term Liabilities

Other long-term liabilities include unearned revenues received in advance from State and Federal governments, and advances for plant replacements. In fiscal 2013, these other long-term liabilities decreased by \$8.9 million to an ending balance of \$175.6 million compared to \$184.5 million for fiscal 2012. These decreases are primarily due to increased State reimbursements for recreation and increased replacement expenses for San Joaquin Field Division.

Accounts Payable and Other Current Liabilities

Accounts payable and other current liabilities totaled \$365.6 million at June 30, 2013, compared to \$335.5 million in fiscal 2012, and \$299.2 million in fiscal 2011. The increase of \$30.1 million in the current year is due to an increase in accounts payable vendor liabilities of \$18.5 million resulting from increases in liquidated damages and retentions and timing differences; an increase of \$6.4 million for the current portion of the System's pollution remediation obligations; an increase of \$1.4 million for the current liability portion of accrued vacation and loans payable; and an increase of \$15.1 million due to timing differences in the transfer of cash settlements with DWR's Internal Service Fund. These increases are offset by a decrease of \$7.7 million for the current portion of long term bond principal and a decrease of \$3.6 million in accrued bond interest.

In fiscal 2012, the increase of \$36.3 million is due to an increase in accounts payable vendor liabilities of \$28.1 million which resulted from increased invoices billed to the System for Reid Gardner power activities and significant contract and consulting services performed during that fiscal year and billed in the next fiscal year. Other changes included an increase of \$9.3 million for the current portion of long term bond principal; an increase of \$1 million for the current portion of the System's pollution remediation obligations for the Delta Methylmercury Control Program; an increase of \$686 thousand to the current liability portion of accrued vacation; a decrease of \$2.8 million due to a timing differences in the transfer of cash settlements with DWR's Internal Service Fund and slight decreases in accrued bond interest and current portions of loans payables.

Proceeds Due to Water Contractors

Proceeds Due to Water Contractors are comprised primarily of the additional 25% billing for revenue bond debt service in excess of debt service requirements (known as "cover"), plus certain investment income and off-aqueduct power sales, all defined as refundable to the Water Contractors under terms of the water supply contracts.

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Proceeds Due to Water Contractors decreased by \$43.3 million during fiscal 2013 to an ending balance of \$98.7 million. This decrease can be primarily attributed to the \$36.3 million decrease in refunds due to the Water Contractors resulting from a fiscal year 2012 accrual realized in the current fiscal year. Another major decrease includes \$15.7 million of deferred operating revenue collected in advance in fiscal 2013 which did not occur in fiscal 2012. These decreases were offset by a \$4.3 million increase in interest earned on debt service reserve balances and \$4.4 million increase in revenues collected in advance for cover which have not yet been returned to the water contractors.

In fiscal 2012, Proceeds Due to Water Contractors increased from \$111 million to \$142 million, an increase of \$31 million. An increase of \$36.4 million was due to refunds to the water contractors as a result of implementing the Springing Amendment which lowered the debt service reserve requirement. Other increases include a \$3.3 million in refunds due to water contractors for adjustments in the Off Aqueduct Power facility charges, a \$6.3 million in deferred operating revenue prepayments for Off Aqueduct Power facility charges, and a \$2.3 million increase in cover. These increases were offset by a \$9.9 million refund to the Water Contractors for the discontinued gas hedging activities, \$5.2 million decrease in interest earnings to be refunded to the Water Contractors, and a \$2.2 million decrease in delivery structure revenue recognized for the North Bay Aqueduct Alternate Intake Project.

Deferred Inflows of Resources

Deferred inflows represent revenues received by the System which are applicable to future reporting periods. In fiscal 2013, the deferred inflows increased by \$177.9 million to an ending balance of \$471.4 million compared to \$293.5 million for fiscal 2012. Deferred inflows for operations and maintenance expense under the Burns Porter Act segment activities increased by \$45 million primarily due to increases in water supply revenues resulting from higher rates for water deliveries, decreases in prior year over collections adjustments, and an extended supplemental funding for DHCCP. Deferred inflows for capital costs increased by \$142 million primarily due to refundings of multiple bond series and net revenues collected for principal payments of previous costs incurred to construct UPIS assets. These increases were offset by a decrease of \$9.8 million in power sales credits due to water contractors.

Operating Revenues

Operating revenues for fiscal 2013 were \$1.12 billion compared to \$1.04 billion in fiscal 2012 and \$1.09 billion in fiscal 2011. The increase of \$81.3 million in fiscal 2013 was primarily due to an increase in water supply revenue of \$70.9 million mainly due to higher rates for water deliveries, decreases in prior year over collections adjustments, and an extended supplemental funding for DHCCP, an increase of \$12.5 million in federal reimbursements offset by a decrease in power sales revenue of \$2.1 million. The decrease of \$50.4 million in fiscal 2012 was primarily due to a decrease in water supply revenue of \$13.9 million, and a decrease in power sales revenue of \$44.8 million offset by an increase of \$8.3 million in federal reimbursements.

Water Supply Revenue

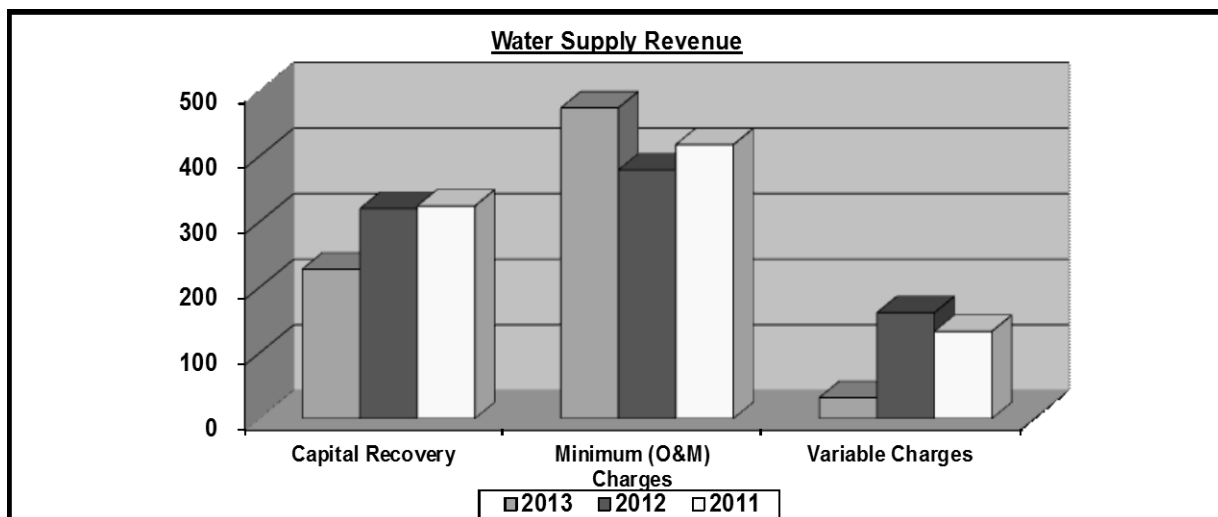
Under the terms of the water supply contracts, the System is required to collect from the Water Contractors all costs of the SWP allocated to water supply in proportion to each Water Contractor's contractual allocation of water. Generally, the System's costs, including the costs of gathering, storing, conveying and delivering water, and interest, are billable to Water Contractors whether or not water is delivered.

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Water supply revenues consist of three main categories, as defined in the water supply contracts: Capital, Minimum and Variable. The Capital component of revenue enables the System to recover all the costs plus interest related to the construction of the System facilities, including its dams, aqueducts, pumping stations and power plants. Once a project is completed, its cost plus interest are amortized and recovered over the remaining term of the water supply contracts (through 2035). The Minimum component of revenue enables the System to recover the operating and maintenance costs associated with operating the System. These costs are generally recovered as they are incurred. Finally, the Variable component of revenue enables the System to recover the net cost of energy used to deliver water to the Water Contractors. Similar to Minimum, these costs, net of power sales, are generally recovered as they are incurred.

On or before July 1 of each year, the System furnishes each Water Contractor with a statement of estimated charges for the Capital, Minimum, and Variable components for the following calendar year. The Capital components are due on January 1 and July 1 of the year following receipt of the statement of charges. The Minimum and Variable component payments are due in twelve monthly installments commencing on January 1 of the year following receipt of the statement of charges. On or about July 1 of each year, the System determines the rate (per acre-foot) to be charged to each Water Contractor in the following calendar year for the Variable components. The Variable components in such calendar year are calculated and billed monthly based on metered water deliveries for the preceding month and the rate determined on July 1st of each year. However, this rate can be modified over the course of the next year. On July 1 of each year, the System furnishes each Water Contractor with a statement showing the difference between the estimated water charges paid and the actual costs incurred in the prior calendar year. The difference is paid by or credited to each Water Contractor, as applicable, in equal monthly installments commencing on January 1 of the year following the “true-up” calculation. This process results in an approximately two-year delay in the reconciliation of estimated charges paid and actual costs reimbursed to the System.

In 2013, the System generated \$931.8 million in water supply revenue, compared to \$860.9 million in fiscal 2012, and \$874.8 million in fiscal 2011. The following table shows a comparative breakdown of the components of water supply revenue for fiscal years 2013, 2012 and 2011.



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Water Supply Billings increased by \$70.9 million in 2013 to a total of \$931.8 million. This increase is due to an increase of \$54.6 million in minimum operating & maintenance (O&M) recovery, a \$33.8 million increase in Variable recovery, offset by a decrease of \$17.5 million in Capital recovery.

Minimum O&M recovery revenues for fiscal 2013 increased by \$54.6 million. The largest increase of \$19.1 million was in recovery revenues for DHCCP due to a supplemental funding agreement that was signed in April 2012, \$16.7 million in Transportation Minimum due to a decrease in prior year over collection adjustments, \$10.3 million in Delta Water Charges (DWC) Minimum due to the DWC minimum rate increase, a \$10 million in replacements transportation revenues due to a decrease in transportation replacements refunds, and a \$4.5 million in Reid Gardner separation costs as the State Water Project's ownership agreement of Reid Gardner Unit No. 4 with Nevada Power Company ending in fiscal year 2014. These increases were offset in part by \$2.6 million decrease in Conservation RAS due to a decrease in RAS rate per acre feet, \$2.4 million in accrued operating revenue, and a \$1.9 million in East Branch Enlargement O&M revenues due to a decrease in over collection applied to revenue.

The Variable recovery revenues increase of \$33.8 million is primarily due to a 6.5 mills/kWh increase in the average mil rate. The average mil rate in 2013 was 43.12 mills/kWh compared to 36.62 mills/kWh in 2012. Actual water deliveries in fiscal 2013 were 2.70 million acre-feet compared to 3.39 million acre-feet in fiscal 2012. Although the water deliveries decreased by 0.69 million acre-feet, the increase in the average mil rate results in \$15.8 million additional recovery revenues. An additional \$16 million increase in revenues resulted from a decrease in prior year over collections which amounted to \$28.8 million in fiscal 2013 compared to \$44.8 million in fiscal 2012 and \$2 million in wheeling water revenue.

The Capital recovery revenues decrease of \$17.5 million is primarily due to decreases of \$11.4 million in Off-Aqueduct Debt Service revenue due to the State Water Project's ownership agreement of Reid Gardner Unit No. 4 with Nevada Power Company ending in fiscal year 2014, \$6.1 million in decreases in Capital Delta Water Charge and Capital Transportation revenues resulting from decreases in the projected conservation and transportation capital costs, and \$1.6 million in East Branch Enlargement Debt Service due to prior year over collections. These decreases were offset by \$1.9 million in South Bay Aqueduct Enlargement Debt Service resulting from issuance of the CVP Series AN.

In fiscal 2012, Water Supply Billings decreased by \$13.9 million to a total of \$860.9 million. There were several contributing factors. A \$38.4 million decrease occurred as a result of O&M recovery, a \$4.1 million decrease in Capital recovery, with an offsetting increase of \$28.6 million in Variable recovery. The decrease in O&M recovery was primarily due to a decrease of \$57.6 million in recovery revenues for DHCCP due to lack of a funding source, and a decrease of \$19.3 million was for adjustments in the Off-Aqueduct Power recovery revenues due to lower fuel and transmission costs and higher Off-Aqueduct power sales. Although replacement recoveries increased by \$4.1 million, \$10 million was refunded to the water contractors to lower the balance in the reserve account which resulted in a net decrease in replacements of \$5.9 million. These decreases were offset in part by a \$10.4 million increase in the Minimum Delta Water Charge billings and \$29.1 million in the Transportation Minimum billings to recover operational costs to meet environmental compliances. Additional increases include \$3.8 million in recovery for the Reid Gardner Unit No. 4 separation costs and \$2.7 million increase of Delivery Structure revenues collected in advance for the North Bay Aqueduct Alternate Intake

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Project, and by \$1 million in East Branch Enlargement revenues, offset by \$2.7 million in decreases in other revenues. The decrease in Capital recovery revenues was primarily due to increases in rate management credits given to the Water Contractors for Capital Delta Water Charge and Capital Transportation. The increase in Variable recovery was primarily due to an increase in the average mil rate and an increase in revenues as a result of prior year under collections.

Overview of the System's Power Activities

The SWP is one of the largest consumers and suppliers of electric power in the western United States. Since the commencement of the major facilities of the SWP in the 1960s, the System has been an active participant in the power markets of California and the western United States. The System has provided for the financing, construction and operation of a variety of power projects including hydroelectric, geothermal and coal-fired electric generating facilities and facilities to transmit electric energy. The System currently owns eight power plants with a total nameplate capacity of approximately 1,800 Mw and with total annual energy generation in recent years ranging between approximately 3,100 and 7,500 Gwh. The System also owns and operates 23 pumping plants with a total load, when operational, of approximately 2,000 Mw and total annual energy consumption in recent years ranging between 5,300 and 10,000 Gwh. Typically, the majority of generation is during the on-peak hours; however, ancillary services are provided in all hours of the day.

Every hour the SWP must enter the power market to facilitate the operation of the California aqueduct. Operations continue 24 hours a day, seven days a week, with constant coordination with other utilities, water contractors, the California Independent System Operator (CAISO), and State Water Project pumping and generating plants. The power market controlled by CAISO can affect the bottom line cost or revenue from the System's hydroelectric facilities.

Every year the DWR is confronted with factors that affect how the operation of the SWP is conducted. Some factors include plant or unit outages, environmental concerns, weather, fluctuation in natural gas prices, transmission line outages and wild fires. In fiscal year 2013, the SWP was affected by the loss of the Thermalito Hyatt Power Plant (THPP) due to fire, subsidence in the California aqueduct, elevation restrictions in the O'Neill forebay due to pondweed and ongoing unavailability of units at DWR's Oroville complex. In addition, slightly below average rainfall continued during fiscal year 2013 which did not allow adequate recovery for System reservoirs to maintain consistent water allocation to the water contractors. The SWP experienced both a decrease in energy sales and purchases in fiscal 2013.

The limited resources and the loss resource at Oroville create a condition that will not allow regulation or ancillary services bids to be submitted in the CAISO market. Ancillary services are generally capacity bids at a qualified resource, allowing that resource the opportunity to recover costs through the ancillary service market. This condition greatly impacted the System's power activities in fiscal 2013.

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Power Sales

Energy sales from SWP hydroelectric generating plants allow some recovery of cost of the System's hydroelectric pumping plants. Running the pumping plants as much as possible when energy prices are generally lower and generating energy during on-peak hours, when prices are generally higher is a proven strategy of the SWP. Reservoir storage levels greatly impact the SWP's ability to recover costs as generating energy requires more than adequate reservoir storages. The Oroville complex is the largest SWP resource and required by FERC to help mitigate negative environmental impacts. Mitigation could include controlling river temperatures, to assisting with after-bay and fore-bay elevation control, to help with nesting Grebe or Garter snake habitat. Required mitigation can occur despite having minimal storage available at Oroville Lake.

In fiscal 2013, power sales decreased by \$2.1 million to a total of \$146.3 million. The decrease in power sales is attributable to a decrease in the transmission sold by \$4.4 million, and is offset by an increase in the power sales of \$2.3 million due to the fact that the System experienced a decrease in the quantity of energy sold and a substantial increase in the MWh rate. In fiscal 2012, 988,839 MWh were sold compared to 790,103 MWh in fiscal 2013, a 20.10% decline from the prior year. The MWh rate increased by 27.61%, from \$118.74 in fiscal 2012 to \$151.53 in fiscal 2013.

A decrease in scheduled water deliveries because of a decrease in rainfall resulted in an increase power available for sale. Water deliveries decreased from 3.39 million acre-feet in fiscal 2012 to 2.7 million acre-feet in 2013, a decrease of 0.69 million acre-feet or 20.29%.

In fiscal 2012, power sales decreased by \$44.8 million to a total of \$148.3 million. The system experienced a decrease in the quantity of energy sold and a slight decrease in the MWh rate as well as a decrease in Transmission sold. In fiscal 2011, 1,338,296 MWh were sold compared to 998,839 MWh in fiscal 2012, a 26.11% decline from the prior year. The overall rate decreased by 0.55%, from \$119.4 in fiscal 2011 to \$118.74 in fiscal 2012. The drop in sales was also impacted by the prolonged unit outages at Oroville.

The following tables show the relationship between volume and rate for fiscal 2013 compared to fiscal 2012, and fiscal 2012 compared to fiscal 2011:

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	<u>Total Sold</u>	<u>Transmission Sold</u>	<u>Power Sold</u>	<u>MWh Sold</u>	<u>Rate/MWh</u>
2012	\$ 148,360,007	\$ (30,945,193)	\$ 117,414,814	988,839	\$ 118.74
2013	146,277,485	(26,554,940)	119,722,546	790,103	151.53
Change in MWh sold					(198,736)
Multiplied by 2012 rate/MWh					\$ 118.74
Difference attributed to decrease in sales					<u>\$ (23,598,000)</u>
Change in MWh rate					\$ 32.79
Multiplied by 2013 MWh sold					790,103
Difference attributed to rate change					<u>\$ 25,907,000</u>
Total increase in power sales					<u>\$ 2,309,000</u>

	<u>Total Sold</u>	<u>Transmission Sold</u>	<u>Power Sold</u>	<u>MWh Sold</u>	<u>Rate/MWh</u>
2011	193,153,799	(33,357,996)	\$ 159,795,803	1,338,296	\$ 119.40
2012	148,360,007	(30,945,193)	117,414,814	988,839	118.74
Change in MWh sold					(349,457)
Multiplied by 2011 rate/MWh					\$ 119.40
Difference attributed to decrease in sales					<u>\$ (41,725,000)</u>
Change in MWh rate					\$ (0.66)
Multiplied by 2012 MWh sold					988,839
Difference attributed to rate change					<u>\$ (653,000)</u>
Total decrease in power sales					<u>\$ (42,378,000)</u>

Federal and State Reimbursements Revenue

Federal reimbursements revenue for fiscal 2013 was \$49.1 million, compared to \$36.6 million for fiscal year 2012. The current year increase of \$12.5 million is due to an increase of \$7.5 million in Capital and O&M recreation cost recovery from the newly appropriated Davis Dolwig fund. In addition there was a \$15.6 million increase in DHCCP revenue due to a one-time amendment with San Luis-Delta Mendota Water Authority to fund cost of environmental analysis, planning and design of delta conservation measures which was completed in June 2013, and an increase of \$1.9 million in the Suisan Marsh O&M share. These increases were offset by a \$12.5 million decrease in DHCCP invoices billed in this current fiscal year. These facilities are located within the Delta, San Luis, and Suisun Marsh facilities for which the System is reimbursed by the Federal and State governments.

Operating Expenses

Total operating expenses decreased by \$44.4 million for fiscal 2013 to a total of \$907.9 million. The decrease is due to a reduction in deferred expenses of \$48.7 million, a decrease in power purchases of \$12.5 million, and a decrease in depreciation and amortization expense of \$2.2 million. These were offset by an increase of \$19 million in operations and maintenance expense.

State Water Resources Development System Management's Discussion and Analysis (Unaudited) For the years ended June 30, 2013 and 2012

Total operating expenses for 2012 decreased by \$37.3 million to a total of \$952 million. The decrease is due to a decrease in power purchases of \$71 million, a decrease in depreciation expense of \$12.9 million and a decrease in deferred expenses of \$51.2 million, offset by an increase of \$97.8 million in operations and maintenance expense.

Operations and Maintenance Expense

Total operations and maintenance expenses were \$545 million for fiscal 2013, compared to \$526 million for fiscal 2012 and \$429 million for fiscal 2011. The increase of \$19 million in fiscal 2013 can be attributed to the following factors: increases of \$19.1 million in natural gas, coal, and diesel consumption; increases in pollution remediation of \$7.8 million; increases in federal co-op contracts of \$6.9 million; increases in consultant and professional services of \$12.5 million; increases in communications of \$5.2 million; increases in bond issuance costs of \$4.8 million; increases in pro-rata cost of \$4.5 million; increases in water supply of \$3.4 million; and other increases in the amount of \$6.8 million comprised of general expenses, Other Post Employment Benefits (OPEB), office equipment rent & repairs, and other miscellaneous expenses. These increases were offset by the following factors: decreases in operations and maintenance of the Reid Gardner power plant of \$21 million; decreases in amounts reclassified to Advances for Plant Replacements of \$8.9 million; decreases in expenses for Reid Gardner coal of \$4.6 million; decreases in maintenance and repair services of \$3.4 million; decreases in vacation expenses of \$2.9 million; and other decreases amounting to \$11.1 million for legal expenses, taxes, fuel and lubricants, easements and other miscellaneous expenses.

The increase of \$97.9 million in fiscal 2012 can be attributed to the following factors: increases of \$29.8 million related to the valuation of easements and internally generated software that were classified as intangible assets in fiscal 2011; increases in salaries and wages of \$26.2 million mainly due to increased personnel to address heightened environmental responsibilities and continued maintenance of the aging infrastructure of the SWP; and an increase of \$11.5 million in the procurement of external consultants, professional, and legal service providers due to heightened environmental compliance efforts. Other increases totaling \$36.8 million included increases for operation and maintenance of the Reid Gardner power plant; maintenance and repairs; remediation expense accrual; pro rata charges for services provided by the State Controller's Office; increases in bond issuance cost; increases in taxes and assessments; increases in overhead; and miscellaneous expenses. These increases were offset by a decrease in OPEB of \$6.4 million.

Power Purchases

The System uses a significant amount of power to operate its pumping stations in order to deliver water to the Water Contractors. The System's sources of power include self-generated power by the eight power plants owned by the System, along with purchases of power from third party suppliers. As with power sales, in any given year, a combination of factors, including hydrological production, energy market rates, and energy market supply and demand, impact the System's energy requirements.

Power purchases decreased \$12.5 million in fiscal 2013 to a total of \$259 million. The decrease of \$17.5 million in power purchased is attributable to a decrease in the quantity of energy purchased offset by an increase in MWh rate, while transmission purchases increased by \$5 million. In fiscal 2012, 3,396,958 MWh were purchased compared to 2,310,252 MWh in fiscal 2013, a 31.99% decline from the prior year. The MWh rate increased by 35% from \$65.54 in fiscal 2012 to \$88.79 in fiscal 2013.

**State Water Resources Development System
Management's Discussion and Analysis (Unaudited)
For the years ended June 30, 2013 and 2012**

Power purchases are generally made for off-peak pumping and are a reflection of water demand. Lack of unit availability caused the need for a flat pumping schedule, operational limitations and unit outages did not allow heavier pumping off-peak and lighter pumping on-peak. The result of the decrease in purchases was not significantly impacted by rainfall in 2013. DWR tends to be more of a net energy purchaser in the energy market due to required water deliveries, which remained reasonable and similar from fiscal 2012 to 2013.

In fiscal 2012, purchased power decreased \$71 million from fiscal 2011 to a total of \$271 million. Of that amount, \$86 million was attributed to increased units purchased and \$22 million was attributed to increase in the average rate per MWh purchased, while changes in transmission decreased by \$8 million.

The following tables show the relationship between volume and rate for fiscal 2013 compared to fiscal 2012, and fiscal 2012 compared to fiscal 2011.

	<u>Total Purchased</u>	<u>Transmission Purchased</u>	<u>Power Purchased</u>	<u>MWh Purchased</u>	<u>Rate/MWh</u>
2012	\$ 271,377,161	(48,734,005)	\$ 222,643,156	3,396,958	\$ 65.54
2013	258,899,223	(53,779,440)	205,119,783	2,310,252	88.79

Change in MWh purchased	(1,086,706)
Multiplied by 2013 rate	\$ 88.79
Difference attributed to decreased purchases	\$ (96,489,000)

Change in MWh rate	\$ 23.25
Multiplied by 2012 purchased	3,396,958
Difference attributed to rate change	\$ 78,979,000

Total decrease in power purchases	\$ (17,510,000)
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	<u>Total Purchased</u>	<u>Transmission Purchased</u>	<u>Power Purchased</u>	<u>MWh Purchased</u>	<u>Rate/MWh</u>
2011	\$ 342,445,800	(56,971,668)	\$ 285,474,132	4,703,953	\$ 60.69
2012	271,377,161	(48,734,005)	222,643,156	3,396,958	65.54

Change in MWh purchased	(1,306,995)
Multiplied by 2012 rate	\$ 65.54
Difference attributed to decreased purchases	\$ (85,660,000)

Change in MWh rate	\$ 4.85
Multiplied by 2011 purchased	4,703,953
Difference attributed to rate change	\$ 22,814,000

Total decrease in power purchases	\$ (62,846,000)
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Operating and Maintenance Expense Recovered

In fiscal 2013, \$18.3 million in operating expenses were recognized, compared to fiscal 2012 in which the System recognized \$67 million in operating expenses. The 2013 net change of \$48.7 million decrease in deferred operation and maintenance expenses recovered is primarily due to increased operations and maintenance revenue billings for DHCCP, water delivery rate increases, decreased prior year billing adjustment to Water Contractors, and increased operations and maintenance expenses. Additionally, certain deferred revenues including

State Water Resources Development System Management's Discussion and Analysis (Unaudited) For the years ended June 30, 2013 and 2012

deferred depreciation, unbilled interest, and unamortized project costs were reclassified to capital and other revenues recovered.

In fiscal 2012, \$67 million in operating expenses recovered were recognized, compared to fiscal 2011 in which the System recognized \$109.5 million in operating expenses. The 2012 net change of \$42.5 million is the result of decreases in operation and maintenance expenses and reclassification of unbilled interest to capital and other revenues recovered.

Capital Revenues Recovered

Capital revenues recovered represents the timing difference between net capital revenue recovered, and certain operating costs incurred. Capital revenues recovered decreased by \$218.8 million in fiscal 2013 as the system recognized amounts in depreciation, unbilled interest and unamortized project cost in excess of current year capital revenues. During fiscal 2012, the System had \$43.8 million in excess capital revenues recovered from the Water Contractors.

Interest Expense

Interest expense for fiscal 2013 was \$53.5 million, which represents a decrease of \$54.2 million from the prior year. This \$54.2 million decrease is attributable to a combination of various factors which include a reduction in total bonds outstanding and restructuring debt through multiple refundings. First, a declining trend in interest costs relating to General Obligation (GO) Bonds and Revenue Bonds lowered interest expense by \$19 million when compared the to the prior year. The decrease in interest expense for GO Bonds reflects a steady decline in the principal balance as principal matures. The decrease in the interest expense for Revenue Bonds reflects the savings realized as a result of restructuring the debt through multiple refundings as DWR took advantage of extremely low rates that prevailed in the bond market during the current year. Second, an additional \$34.6 million decrease is attributable to the write-off of unamortized premium and deferred losses as a result of debt refundings and the implementation of GASB Statement No. 65 in the current fiscal year, which requires that costs of issuance be written off. Prior to the implementation of GASB Statement No. 65, costs of issuance were deferred and amortized.

Interest expense for fiscal 2012 was \$108 million, which represents a decrease of \$27.2 million from the prior year. This \$27.2 million decrease is attributable to three major factors; a \$9.8 million decrease in amortization of bond premium and discount, a \$7.2 million decrease in amortization of deferred losses on defeased bonds, and a \$10.2 million decrease in interest expense on debt service. The \$9.8 million variance in the amortization of premium and discount reflects an \$8.3 million increase in premium write-off and a \$1.5 million increase in amortization of premium and discount. The \$7.2 million decrease in the amortization of the deferred amount on refunding is attributed to an \$8.3 million increase in premium write-off and a \$1.1 million increase in amortization expense when compared to fiscal year 2011. The \$10.2 million decrease in interest expense reflects the decrease in bonds outstanding and the savings resulting from the current year debt refunding.

Other Revenues (Expenses)

Other revenues, net of expenses increased by \$38.8 million from \$29.6 million in expenses for fiscal 2012 to \$9.2 million in revenues for fiscal year 2013. This increase is generally attributable to the release of debt service reserves that occurred in fiscal year 2012 but not in fiscal year 2013.

**State Water Resources Development System
Management's Discussion and Analysis (Unaudited)
For the years ended June 30, 2013 and 2012**

Other revenues, net of expenses decreased by \$35.2 million from \$5.6 million in revenues for fiscal 2011 to \$29.6 million in expenses for fiscal 2012. This decrease is attributable to a \$36.3 million accrual for a debt service release of excess reserves, partially offset by a \$1.4 million increase in bond proceeds.

**State Water Resources Development System
Management's Discussion and Analysis (Unaudited)
For the years ended June 30, 2013 and 2012**

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Financial Statements

State Water Resources Development System
Statements of Net Position
June 30, 2013 and 2012

(in thousands)

	<u>2013</u>	<u>2012</u> <u>(as restated)</u>
Assets		
Utility plant:		
Utility plant in service	\$ 5,165,558	\$ 5,086,686
Less accumulated depreciation	(2,366,429)	(2,281,806)
Net utility plant in service	<u>2,799,129</u>	<u>2,804,880</u>
Construction work in progress	<u>528,836</u>	<u>408,072</u>
Total utility plant	<u>3,327,965</u>	<u>3,212,952</u>
Long-term assets:		
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	31,829	32,227
Cash and investments restricted for debt service	109,790	115,481
Cash and cash equivalents on deposit with revenue bond trustee	9,207	9,205
Amounts recoverable through future billings under long-term water supply contracts:		
Operations and maintenance expense	57,350	29,887
Capital credit due from water contractors	65,019	82,934
Unamortized project costs	322,339	332,302
Unbilled interest incurred on capital costs	452,662	467,632
Loans receivable from local water agencies	16,468	19,142
Advance to other state funds	<u>91,517</u>	<u>91,517</u>
Total long-term assets	<u>1,156,181</u>	<u>1,180,327</u>
Current assets:		
Cash and cash equivalents	559,634	422,404
Receivables:		
Interest on investments	899	1,287
Water supply and power billings (net)	92,373	110,646
Due from federal and state governments	20,227	15,787
Inventories	<u>7,413</u>	<u>29,653</u>
Total current assets	<u>680,546</u>	<u>579,777</u>
Total assets	<u>5,164,692</u>	<u>4,973,056</u>
Deferred outflows of resources:		
Deferral of loss on refunding	<u>124,591</u>	<u>57,930</u>
Total deferred outflows of resources	<u>124,591</u>	<u>57,930</u>
Total assets and deferred outflows of resources	<u>\$ 5,289,283</u>	<u>\$ 5,030,986</u>

The accompanying notes are an integral part of these financial statements.

**State Water Resources Development System
Statements of Net Position (continued)**

June 30, 2013 and 2012

(in thousands)

	<u>2013</u>	<u>2012</u> <u>(as restated)</u>
Capitalization and Liabilities		
Capitalization:		
Net position:		
Net investment in capital assets	\$ 785,460	\$ 684,025
Restricted	419,968	521,403
Total net position	<u>1,205,428</u>	<u>1,205,428</u>
Long-term liabilities		
General obligation bonds	241,835	302,920
Revenue bonds	2,479,684	2,363,582
Commercial paper	50,505	28,783
Other postemployment benefits	140,470	117,924
Pooled Money Investment Account (PMIA) Loan	11,580	14,896
Accrued vacation	33,305	32,939
Pollution remediation	15,107	8,920
Unearned revenue - State and Federal capital recovery	145,651	149,347
Advances for plant replacements	29,938	35,153
Total long-term liabilities	<u>3,148,075</u>	<u>3,054,464</u>
Total capitalization	<u>4,353,503</u>	<u>4,259,892</u>
Current liabilities:		
Current maturities of bonds	175,860	183,610
Accounts payable	106,490	88,025
Accrued vacation	8,612	7,318
Pollution remediation	8,400	2,000
Accrued interest on long-term debt	13,741	17,370
Pooled Money Investment Account (PMIA) Loan	3,316	3,156
Due to other state funds	49,172	34,024
Proceeds due to water contractors	98,753	142,048
Total current liabilities	<u>464,344</u>	<u>477,551</u>
Total Liabilities	<u>3,612,419</u>	<u>3,532,015</u>
Deferred inflows of resources:		
Operations and maintenance expense	47,889	2,154
Capital costs	265,135	123,153
Power sales credit due to water contractors	158,412	168,236
Total deferred inflows of resources	<u>471,436</u>	<u>293,543</u>
 Total net position, liabilities, and deferred inflows of resources	 <u>\$ 5,289,283</u>	 <u>\$ 5,030,986</u>

The accompanying notes are an integral part of these financial statements.

State Water Resources Development System
Statements of Revenues, Expenses, and Changes in Net Position
For the years ended June 30, 2013 and 2012 **(in thousands)**

	2013	2012 (as restated)
Operating revenues:		
Water supply	\$ 931,808	\$ 860,891
Power sales	146,277	148,360
Federal reimbursements	49,110	36,561
Total operating revenues	1,127,195	1,045,812
 Operating expenses:		
Operations and maintenance	545,413	526,402
Purchased power	258,899	271,377
Depreciation and amortization expense	85,236	87,400
Operating expenses recovered, principally under long-term water supply contracts, net	18,325	67,063
Total operating expenses	907,873	952,242
 Income from operations	219,322	93,570
 Nonoperating revenue (expenses):		
Capital revenues recovered (deferred)	(175,005)	43,834
Interest expense	(53,492)	(107,770)
Other revenues (expenses), net	9,175	(29,634)
 Change in net position	-	-
 Net position, beginning of year, as restated	1,205,428	1,205,428
Net position, end of year	\$ 1,205,428	\$ 1,205,428

The accompanying notes are an integral part of these financial statements.

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State Water Resources Development System
Statements of Cash Flows
For the years ended June 30, 2013 and 2012

(in thousands)

	2013	2012 (as restated)
Cash flows from operating activities:		
Receipts from customers	\$ 1,088,771	\$ 1,045,826
Payments to employees for services	(273,393)	(258,226)
Payments to suppliers	(438,273)	(478,686)
Other expenses	2,709	(36,488)
Net cash provided by operating activities	<u>379,814</u>	<u>272,426</u>
Cash flows from capital and related financing activities:		
Proceeds from issuance of revenue obligation bonds including premium	267,762	112,033
Principal payments on long-term debt	(183,610)	(174,315)
Commercial paper notes issued	121,961	75,444
Principal payments on commercial paper notes	(100,239)	(101,239)
Principal payments on PMIA note	(3,156)	(3,003)
Interest payments on long-term debt	(160,668)	(139,367)
Additions to utility plant and CWIP	(200,249)	(98,887)
Net cash used by capital and related financing activities	<u>(258,199)</u>	<u>(329,334)</u>
Cash flows from investing activities:		
Cash received from investment earnings	8,468	6,991
Proceeds of investments matured	302,608	302,608
Purchases of investments	(302,608)	(302,608)
Loan payments from local water agencies	2,674	1,898
Net cash provided by investing activities	<u>11,142</u>	<u>8,889</u>
Net increase (decrease) in cash and cash equivalents	132,757	(48,019)
Cash and cash equivalents, beginning of year	<u>503,702</u>	<u>551,721</u>
Cash and cash equivalents, end of year	<u>\$ 636,459</u>	<u>\$ 503,702</u>
Noncash capital and related financing activities:		
Amortization of Bond Premium/Discount	\$ 36,885	\$ 16,431
Principal retirements of long-term debt on proceeds received from issuance of Series AI, AJ, AK, AL, AN, AO and AM Water System Revenue Bonds	632,125	266,785
Noncash capital and related financing activities:	<u>\$ 669,010</u>	<u>\$ 283,216</u>

The accompanying notes are an integral part of these financial statements.

State Water Resources Development System
Statements of Cash Flows (continued)
For the years ended June 30, 2013 and 2012

(in thousands)

	2013	2012 (as restated)
Reconciliation to the statement of net position:		
Cash and cash equivalents	\$ 559,634	\$ 422,404
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	31,829	32,227
Cash and cash equivalents restricted for debt service (net of \$74,001 and \$75,615 of U.S. Agency securities for 2013 and 2012, respectively)	35,789	39,866
Cash and cash equivalents on deposit with revenue bond trustee	9,207	9,205
Cash and cash equivalents	\$ 636,459	\$ 503,702

	2013	2012
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	\$ 219,323	\$ 106,008
Adjustment to reconcile income from operations to net cash provided by operating activities		
Depreciation expense	85,236	87,400
Other expenses	2,709	(36,488)
Decrease in deferred charges and credits, net	9,362	52,072
Changes in assets and liabilities:		
Decrease (increase) in receivables	18,273	(29,868)
Decrease in inventories	22,240	3,331
(Increase) decrease in due from state and federal governments	(4,440)	3,838
Increase in accounts payable, accrued vacation, pollution remediation and other postemployment benefits	55,258	57,612
Increase (decrease) in due to other state funds	15,148	(2,523)
Increase (decrease) in proceeds due to Water Contractors	(43,295)	31,044
Total adjustments	160,491	166,418
Net cash provided by operating activities	\$ 379,814	\$ 272,426

The accompanying notes are an integral part of these financial statements.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

1. Reporting Entity

The State Water Resources Development System (System), administered by the Department of Water Resources (DWR), includes the State Water Project (SWP), the Davis-Grunsky Act Program and the San Joaquin Drainage Implementation Program, was constructed as the result of initial legislation in 1951 and subsequent legislation in the 1960s providing various financing mechanisms. The SWP is a complex of dams, water storage facilities, aqueducts, pumping stations and electric generation facilities which have been constructed for purposes of developing firm water supply and conveying water to areas of need within the State and providing flood control, recreation, fish and wildlife enhancement and hydroelectric power. The System has entered into long-term water supply contracts with 29 customers (Water Contractors) in order to recover substantially all System costs. The 29 Water Contractors are principally located in the San Francisco Bay Area, the Central Valley and Southern California and their service areas encompass approximately 25% of the State's land area and 70% of its population.

The System is accounted for as an enterprise fund comprised of two segments, and is financed and operated in a manner similar to that of a private business enterprise. The System uses the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

2. Summary of Significant Accounting Policies

Utility Plant

Utility plant is recorded at original cost. Cost includes labor, materials and indirect items such as engineering, supervision, transportation and interest on borrowed funds incurred during construction. Repairs, maintenance and minor purchases of equipment are charged to expense as incurred.

Depreciation

Depreciation is provided on a straight-line basis over the estimated useful lives of the various classes of utility plant, as follows:

Aqueducts	80 - 100 years
Dams and reservoirs	85 years
Environmental preservation and mitigation	50 years
Power plants	30 - 50 years
Pumping plants	30 - 40 years
Fish protection	35 - 36 years
Facilities	20 - 30 years
Machinery, equipment and vehicles	3 - 5 years
General	5 years

The System's intangible assets, consisting of software, land use and legal rights, costs associated with the FERC licenses, and compliance instruments are included in utility plant in service. Software costs are being amortized on a straight-line basis over a 10 year useful life. Easements are land use rights and considered as either permanent or temporary. Permanent easements have an indefinite useful life and are non-depreciable while temporary easements are being depreciated over a 5 year useful life, unless otherwise

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

specified in the purchase agreement. A central element of California's Global Warming Solutions Act (AB32) requires the System to obtain and surrender emissions credits and allowances. Currently, these compliance instruments consist of Green House Gas (GHG) emissions allowances for Reid Gardner Unit No. 4 (RG4) and the System's share of compliance cost for the Lodi Energy Center (LEC). Since the economic benefit isn't diminished until the credits are consumed, they will not be amortized. The credits will be included in utility plant in service and charged to expense as they are sold or used.

Cash and Cash Equivalents

Cash and cash equivalents, for purposes of the statement of cash flows, includes cash on hand, restricted cash for plant replacements, restricted cash for debt service and restricted cash on deposit with revenue bond trustee. Such amounts include deposits in the State of California Pooled Money Investment Account-Surplus Money Investment Fund (SMIF) and instruments with original maturities of three months or less. Cash and cash equivalents do not include U.S. Government and Agency securities with maturities of more than three months.

Restricted Cash and Investments

Cash on deposit with revenue bond trustee consists of debt service reserve funds held with a major national bank for the Series 1973 Devil Canyon – Castaic Facilities bonds.

Cash and investments with the State Treasurer for plant replacements and debt service are restricted as required by the provisions of the water supply contracts and bond resolutions. Restricted funds consist of investments of the same type as those described below.

Investments

Cash not required for current use, including restricted cash, is invested in the Surplus Money Investment Fund (SMIF), which is stated at fair value. SMIF is part of the State of California Pooled Money Investment Account (PMIA), which as of June 30, 2013 and 2012 had a balance of \$61.1 billion and \$62.7 billion, respectively. The weighted average to maturity of PMIA investments was 278 days and 270 days as of June 30, 2013 and 2012, respectively. The total amount of deposits in SMIF was \$30 billion for June 30, 2013 and 2012. The Pooled Money Investment Board (PMIB) has oversight responsibility for SMIF. The Board consists of three members as designated by state statute. The value of the pool shares in SMIF which may be withdrawn is determined on an amortized cost basis, which is different than the fair value of the System's portion of the pool. PMIA funds are on deposit with the State's Centralized Treasury System and are not SEC registered, but are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. These investments consist of U.S. government securities, securities of federally-sponsored agencies, U.S. corporate bonds, interest bearing time deposits in California banks, prime-rated commercial paper, bankers' acceptances, negotiable certificates of deposit, repurchase and reverse repurchase agreements. The PMIA policy limits the use of reverse repurchase agreements subject to limits of no more than 10% of PMIA. The PMIA does not invest in leveraged products or inverse floating rate securities. Included in PMIA's investment portfolio are structured notes and asset-backed securities totaling \$400 million and \$753 million as of June 30, 2013 and \$800 million and \$1.3 billion as of June 30, 2012.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

The System is authorized by statute to invest in the same types of investment vehicles permitted by the State's Centralized Treasury System. U.S. Treasury and agency debt securities are carried at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, and is determined from published data provided by the exchanges, computerized pricing sources, the National Association of Securities Dealers' National Market System, securities custodians, and other authoritative sources. Investments made by the System during the year ended June 30, 2013, are of a similar nature as those held at June 30, 2012.

Advance to Other State Funds

Advance to Other State Funds represents the System's advance of \$92 million to DWR's internal service fund, and functions as a revolving working capital facility for the System.

Receivables

Receivables include amounts due from the Water Contractors and organizations that purchase power from the System, totaling \$92,373 and \$110,646, net of the allowance for uncollectible amounts, at June 30, 2013 and 2012, respectively. Additionally, the Federal government owed the System \$20,227 and \$15,787 at June 30, 2013 and 2012, respectively, as reimbursement for certain costs related to flood control and jointly owned facilities. The allowance for uncollectible amounts totaled \$129 and \$197 at June 30, 2013 and 2012, respectively. Uncollectible amounts are generally recoverable from the Water Contractors.

Amounts Recoverable through Future Billings

The System records unbilled costs as assets recoverable through future billings under long-term water supply contracts. These costs include operations and maintenance costs and capital costs.

Unamortized project costs represent abandoned utility plant and research and development expenses that are recoverable through future billings to the Water Contractors under the terms of the water supply contracts.

Unbilled interest incurred on unrecovered capital costs are classified as other long-term assets until billed under the terms of the water supply contracts. Unbilled interest incurred represents the System's unrecovered interest since inception, recalculated annually at the System's cumulative weighted average cost of borrowing (Project Interest Rate). The System's Project Interest Rate was 4.610% for the years ended June 30, 2013 and 2012.

Deferred Outflows and Inflows

The System has the authority to establish the level of rates to recover all System costs, including debt service. As a regulated entity, the System's financial statements are prepared in accordance with the Governmental Accounting Standards Board. The System is considered to be a Regulated Operation pursuant to GASB Statement No. 62, which requires that the effects of the rate-making process be recorded in the financial statements. Accordingly, certain expenses and credits, normally reflected in the change in net position, as incurred, are recognized when included in rates and recovered from, or refunded to customers and the state and federal governments. The System records various regulatory assets and credits to reflect rate-making actions of management. With the implementation of GASB Statement No. 65, the System records costs of loss on refunding as deferred outflows of resources and revenues that are in excess of total project costs from inception of

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

the SWP as deferred inflows of resources. These costs include capital costs and operations and maintenance costs.

Deferred Outflows of Resources

Deferral of loss on refunding represents the difference between the reacquisition price and the net carrying amount of the old debt. With the implementation of GASB Statement No. 65, this is reported as deferred outflows of resources.

Deferred Inflows of Resources

Operations and maintenance expenses represent operations and maintenance revenues collected in excess of operations and maintenance expenses incurred resulting from specific terms of long-term water supply contracts and timing differences. Under the System's Burns Porter Act segment, the System had an ending balance of \$47.9 million and \$2.2 million in deferred inflows of operations and maintenance expenses for the years ended 2013 and 2012 respectively.

Since the capital component of revenue allows for the recovery of capital costs plus interest related to the construction of the System's facilities, these revenues are presented as deferred inflows of resources. As these facilities are depreciated over time, the deferred capital costs are recovered. Deferred inflows of resources for capital costs increased by \$142 million to an ending balance of \$265.1 million in fiscal 2013 compared to \$123.1 million in fiscal 2012. This increase is primarily due to refundings of multiple bond series and net revenues collected for principal payments of previous costs incurred to construct UPIS assets.

The power sales credit arises from revenue collected for the power generated by the Hyatt-Thermalito Power Plant. The power sales credit is amortized over time by a credit issued to the Water Contractors through the Delta Water Capital Charge. The power sales credit decreased by \$9.8 million to an ending balance of \$158.4 million in fiscal 2013 compared to \$168.2 million in fiscal 2012.

Unearned Revenue – State and Federal Capital Recovery

Unearned Revenue represents payments by the State and Federal governments for their share of the System's recreation and flood control capital costs in excess of the related depreciation expense recognized in the statements of revenues, expenses, and changes in net position.

Advances for Plant Replacements

Advances for plant replacements represent billings under the terms of water supply contracts for future replacement of certain System assets. Assets from such billings are restricted. Costs of plant replacements are charged to the reserve as incurred.

Bond Issuance Discounts and Premiums

Bond issuance discounts and premiums are reflected as a reduction/increase to the carrying value of the bonds outstanding and are amortized over the lives of the related debt instruments.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

Net Position

The System classifies its net position into two components, net investment in capital assets and restricted net position. Net investment in capital assets includes total utility plant, net investment in capital assets and unrestricted net position, related long-term debt and other assets and liabilities relating to the recovery of utility plant. The remaining net position of the System are classified as restricted due to the requirements of legislation that created the System and authorized the construction of the SWP, to use the System's net assets solely in support of the SWP, the Davis-Grunsky Act Program and the San Joaquin Drainage Implementation Program.

Revenues

The cost of providing services from the System is required to be recovered through user charges and other reimbursements. Under the terms of the long-term water supply contracts, the System granted the Water Contractors rate management reductions of approximately \$40,450 and \$32,926 during the years ended June 30, 2013 and 2012, respectively. Rate management reductions are permanent reductions in capital related billings to the Water Contractors.

Revenues under long-term water supply contracts are recognized when billings are due and payable. The billings cover debt service requirements, an additional 25% of revenue bond debt service to satisfy certain bond covenants and current and past unrecovered operations and maintenance costs. The water supply contracts provide that the 25% portion of the billings collected for the purpose of satisfying certain bond covenants be refunded in the subsequent year. These billings, which totaled \$54,677 and \$56,385 for the years ended June 30, 2013 and 2012, respectively, are recorded as Proceeds Due to Water Contractors in the financial statements. The System refunded \$49,740 and \$55,849 for the years ended June 30, 2013 and 2012, respectively, to the Water Contractors for the 25% bond cover requirement.

Revenues from the sale of surplus power are recognized as the power is delivered.

The Federal government reimburses the System for certain operating and capital costs incurred by the System for flood control purposes. In addition, the Federal government reimburses the System for the Federal government's 45% share of the operating costs of the San Luis joint use facilities and other water facilities. Revenue from the State and Federal government in excess of their share of the related depreciation expense is deferred until the related depreciation expense is recognized.

Segments

The System has two segments, which are defined under governmental accounting standards as an identifiable activity for which one or more revenue bonds or other revenue-backed debt instruments are outstanding:

1) Activities Allowed Under the Burns-Porter Act – This segment accounts for the costs to build, operate and maintain the facilities financed by general obligation bonds as authorized by the Burns-Porter Act. Transportation and conservation revenues from the Water Contractors are recorded in this segment as well as power sales and reimbursements from Federal and State governments, and interest on investments. Expenses are limited to operations and maintenance of the SWP constructed with general obligation bond proceeds, power purchases, replacements and debt service on the general obligation bonds.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

2) Activities Allowed Under the Central Valley Project Act – This segment accounts for the costs to build, operate and maintain the facilities financed by the Central Valley Project Water System revenue bonds. Capital and operating revenues from the Water Contractors for projects financed by revenue bond proceeds are recorded in this segment as well as commercial paper sales, reimbursements from Federal and State governments for the San Luis Dam and Reservoir, Suisun Marsh and recreation costs, and interest on investments. Expenses are limited to the construction and operation of SWP facilities constructed with revenue bond proceeds and power facilities, and debt service payments on the revenue bonds.

Reclassifications

Certain amounts presented in the prior year have been reclassified in order to be consistent with the current year's presentation.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

3. Interests in Jointly Owned Facilities

At June 30, 2013 and 2012, the System owned the following undivided interests in jointly owned facilities:

	% Owned by System		System's Share			
			Utility Plant in Service		Accumulated Depreciation	
	2013	2012	2013	2012	2013	2012
Reid Gardner Power Plant Unit No. 4	67.8%	67.8%	\$ 362,656	\$ 359,959	\$ 362,656	\$ 344,857
San Luis joint use facilities	55.0%	55.0%	281,740	281,455	129,178	125,068

The amounts above include the System's share of direct costs related to building the facilities. Each participant provides its own financing for the jointly owned facility.

DWR is the operator of the San Luis joint use facilities. All of the operating expenses related to these facilities are included as operating expenses in the statement of revenues, expenses, and changes in net position. The Federal government is billed for its share of the operating expenses, and these billings are included as operating revenues in the statement of revenues, expenses, and changes in net position.

DWR does not operate the Reid Gardner Power Plant Unit No. 4. The portion of Reid Gardner Power Plant Unit No. 4 operations attributable to the System's share is included in operations and maintenance expense in the statement of revenues, expenses, and changes in net position.

DWR will have no ownership in the Reid Gardner Power Plant Unit No. 4 effective July 25, 2013. The contract between DWR and Nevada Energy (NVE), the operator of the Reid Gardner Power Plant Unit No. 4, will terminate on July 25, 2013, with the System's share of Reid Gardner being fully capitalized and depreciated as of June 30, 2013.

State Water Resources Development System
Notes to Financial Statements
For the years ended June 30, 2013 and 2012

(in thousands)

4. Utility Plant

The summarized activity of the System's utility plant during 2013 is presented below:

	Beginning Balance June 30, 2012	Transfers and Additions	Transfers and Deletions	Ending Balance June 30, 2013
Nondepreciable Utility Plant:				
Land	\$ 136,129	\$ 701	\$ (33)	\$ 136,797
Construction work in progress (CWIP)	408,072	185,970	(65,206)	528,836
Land use rights	11,250	299	-	11,549
Other intangible assets	88,930	11,134	-	100,064
Total nondepreciable utility plant	644,381	198,104	(65,239)	777,246
Depreciable Utility Plant:				
Aqueducts	2,064,208	7,047	-	2,071,255
Dams & reservoirs	781,202	206	-	781,408
Power plants	906,554	5,149	-	911,703
Pumping plants	829,344	7,311	-	836,655
Environmental preservation and mitigation	67,797	-	-	67,797
Fish protection	33,934	-	-	33,934
Facilities	65,820	410	-	66,230
Equipment and other depreciable assets	70,593	1,839	(613)	71,819
Computer software	24,162	339	-	24,501
Land use rights	272	-	-	272
Other intangible assets	-	11,995	-	11,995
General	6,491	33,088	-	39,579
	4,850,377	67,384	(613)	4,917,148
Less: accumulated depreciation	(2,267,628)	(82,753)	613	(2,349,768)
Less: accumulated amortization	(14,178)	(2,483)	-	(16,661)
	(2,281,806)	(85,236)	613	(2,366,429)
Total depreciable plant	2,568,571	(17,852)	-	2,550,719
Total Utility Plant - net	\$ 3,212,952	\$ 180,252	\$ (65,239)	\$ 3,327,965

State Water Resources Development System
Notes to Financial Statements
For the years ended June 30, 2013 and 2012

(in thousands)

The summarized activity of the System's utility plant during 2012 is presented below:

	Beginning Balance June 30, 2011	Transfers and Additions	Transfers and Deletions	Ending Balance June 30, 2012
Nondepreciable Utility Plant:				
Land	\$ 136,129	\$ -	\$ -	\$ 136,129
Construction work in progress (CWIP)	366,975	88,287	(47,190)	408,072
Land use rights	11,005	245	-	11,250
Other intangible assets	81,976	6,954	-	88,930
Total nondepreciable utility plant	596,085	95,486	(47,190)	644,381
Depreciable Utility Plant:				
Aqueducts	2,057,437	6,771	-	2,064,208
Dams & reservoirs	781,110	92	-	781,202
Power plants	910,100	2,270	(5,816)	906,554
Pumping plants	787,008	42,336	-	829,344
Environmental preservation and mitigation	67,797	-	-	67,797
Fish protection	33,934	-	-	33,934
Facilities	64,810	1,010	-	65,820
Equipment and other depreciable assets	67,996	2,597	-	70,593
Computer software	23,629	533	-	24,162
Land use rights	-	272	-	272
General	5,964	527	-	6,491
	4,799,785	56,408	(5,816)	4,850,377
Less: accumulated depreciation	(2,182,591)	(85,037)	-	(2,267,628)
Less: accumulated amortization	(11,815)	(2,363)	-	(14,178)
	(2,194,406)	(87,400)	-	(2,281,806)
Total depreciable plant	2,605,379	(30,992)	(5,816)	2,568,571
Total Utility Plant - net	\$ 3,201,464	\$ 64,494	\$ (53,006)	\$ 3,212,952

5. Investments

As of June 30, 2013, the System's investments and credit ratings are as follows:

	Credit Rating (S&P)	-----Maturities-----				Fair Value
		Under 30 Days	31-180 Days	181-365 Days	1-5 Years	
Investments:						
Money Market Mutual Funds	Not Rated	\$ 3	\$ -	\$ -	\$ -	\$ 3
PMA	Not Rated	-	-	627,249	-	627,249
US Federal Agency Notes						
Federal National Mortgage Association	AA+	-	50,887	-	23,114	74,001
						<u>701,253</u>
Investment with Fiscal Agent						
Money Market Mutual Funds	AAA	9,207	-	-	-	9,207
Total Investments						<u>\$ 710,460</u>

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

As of June 30, 2012, the System's investments and credit ratings are as follows:

	Credit Rating (S&P)	-----Maturities-----					Fair Value
		Under 30 Days	31-180 Days	181-365 Days	1-5 Years	Over 5 Years	
Investments:							
Money Market Mutual Funds	Not Rated	\$ 3	\$ -	\$ -	\$ -	\$ -	\$ 3
PMIA	Not Rated	-	-	494,494	-	-	494,494
US Federal Agency Notes							
Federal National Mortgage Association	AA+	-	51,160	-	12,202	12,253	75,615
							<u>570,112</u>
Investment with Fiscal Agent							
Money Market Mutual Funds	AAA	9,205	-	-	-	-	<u>9,205</u>
Total Investments							<u><u>\$579,317</u></u>

Interest Rate Risk: In accordance with its investment policy, the State of California manages its exposure to declines in fair value by spreading investments over the various maximum maturities: U.S. Treasury securities, 5 years; federal agency securities, 5 years; bankers acceptances – domestic and foreign, 180 days; certificates of deposits, 5 years; collateralized time deposits, 5 years; commercial paper, 180 days; corporate bonds and notes, 5 years; repurchase agreements and reverse repurchase agreements, 1 year.

Custodial Credit Risk: For deposits, custodial credit risk is that in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code does not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by depository regulated under state law. The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

Credit Risk: PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy discussed in Note 2. The PMIA is not rated.

Concentration of Credit Risk: The PMIA's concentration of credit risk is limited by spreading the investment mix over different investment types, credit ratings and issuers to minimize the impact any one industry, investment class, or institution can have on the PMIA portfolio. As of June 30, 2013 and 2012, nearly 10% and 13%, respectively, of the System's investments at year-end were in U.S. Agency Securities. There is no limitation on amounts invested in these types of issues. Investments in any one issuer (other than U.S. Treasury Notes, mutual funds and external investment pools) that represented 5% or more of the total investments of the System as of June 30, 2013 and 2012, was as follows:

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

	<u>2013</u>	<u>2012</u>
Federal National Mortgage Association	\$ 74,001	\$ 75,615

Interest on deposits in PMIA varies with the rate of return of the underlying portfolio and averaged 0.307% and 0.382% for the years ended June 30, 2013 and 2012, respectively. For the years ended June 30, 2013 and 2012, interest earned on the deposits with PMIA approximated \$1,675 and \$2,188 respectively, and are included in the other revenues (expenses) line item on the statement of revenues, expenses and changes in net position.

Total interest and investment income is comprised of interest, dividends, realized gains and losses, and unrealized gains and losses due to changes in the fair value of investments held at year-end. The change in fair value of the System's investments (U.S. Federal Agency Securities) is calculated as follows:

	<u>2013</u>	<u>2012</u>
Fair Value of Investments at the beginning of the fiscal year	\$ 75,615	\$ 75,313
Less: Proceeds of investments matured in fiscal year	(302,608)	(302,608)
Add: Purchase of investments in fiscal year	302,608	302,608
Add: Amortization of Discounts	63	63
Change in fair value of investments during fiscal year	(1,677)	239
Fair value of investments at the end of the fiscal year	<u>\$ 74,001</u>	<u>\$ 75,615</u>

6. Long-term Debt

The following is a summary of changes in long-term debt for the years ended June 30, 2013 and 2012:

	General			Commercial	PMIA	Total Long	
	Obligation	Revenue Bonds*					Paper
	<u>Par Amount</u>	<u>Par Amount</u>	<u>Unamortized (Discounts) and Premium</u>	<u>Total Revenue Bonds</u>	<u>Par Amount</u>		
Balance at June 30, 2011	\$ 420,540	\$ 2,380,205	\$ 111,649	\$ 2,491,854	\$ 54,578	\$ 21,055	\$ 2,988,027
Additions	-	345,575	49,674	395,249	75,444	-	470,693
Payments/amortization	(58,165)	(382,935)	(16,431)	(399,366)	(101,239)	(3,003)	(561,773)
Balance at June 30, 2012	362,375	2,342,845	144,892	2,487,737	28,783	18,052	2,896,947
Additions	-	822,410	77,477	899,887	121,961	-	1,021,848
Payments/amortization	(59,455)	(756,280)	(36,885)	(793,165)	(100,239)	(3,156)	(956,015)
Balance at June 30, 2013	302,920	2,408,975	185,484	2,594,459	50,505	14,896	2,962,780
Less current portion	(61,085)	(114,775)	-	(114,775)	-	(3,316)	(179,176)
Total Long-term Debt	<u>\$ 241,835</u>	<u>\$ 2,294,200</u>	<u>\$ 185,484</u>	<u>\$ 2,479,684</u>	<u>\$ 50,505</u>	<u>\$ 11,580</u>	<u>\$ 2,783,604</u>

Note: *The column "Deferred Amount on Refunding" has been removed due to the implementation of GASB Statement No. 65.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

General Obligation Bonds

The Burns-Porter Act authorized the issuance of State Water Resources Development (WRD) General Obligation Bonds in the amount of \$1,750,000 for construction of the System. This amount included \$130,000 to be set aside for financial assistance to local water agencies as provided in the Davis-Grunsky Act. The Burns-Porter Act also made a continuing appropriation of the California Water Fund, a fund unrelated to the System, to supplement the bond authorization. To the extent Water Fund money was used for construction of the State water facilities in lieu of bond proceeds, an equal amount of bond authorization was set aside to be used only for the construction of additional facilities of the System that meet certain requirements set forth in the Burns-Porter Act.

Under the Burns-Porter Act, revenues of the System, other than revenues attributable to facilities financed with Central Valley Project Water System (CVP) Revenue Bonds, are deposited in the California Water Resources Development Bond Fund and are to be used annually only for the following purposes and in the following order of priority:

- (1) To pay the maintenance, operation and replacement costs of the System,
- (2) To pay, or reimburse the General Fund of the State for, the principal of and interest on the WRD General Obligation Bonds issued for the System as it becomes due,
- (3) To reimburse the California Water Fund for funds utilized from said fund for construction of the System (complete reimbursement has been made), and
- (4) To pay additional costs of the acquisition and construction of the System.

All such revenues are pledged for those uses and purposes for the benefit of the owners of the WRD General Obligation Bonds.

As of June 30, 2013, the amount of the revenues pledged to repay the Burns-Porter Act WRD General Obligation Bonds debt service is \$347,168 with payments through 2025. Principal and interest paid for the current year were \$74,463 and Burns-Porter Act water supply operating revenues were \$634,675. As of June 30, 2012 the amount of the revenues pledged to repay the Burns-Porter Act WRD General Obligation Bonds debt service were \$421,631 with payments through 2025. Principal and interest paid for 2012 were \$75,728 and Burns-Porter Act WRD water supply operating revenues were \$553,453.

WRD General Obligation Bonds of \$168 million are authorized but un-issued as of June 30, 2013 and 2012, and may only be used for additional facilities, meeting certain requirements of the Burns-Porter Act.

WRD General Obligation Bonds Series A through Series S may be called at any time for early redemption. WRD General Obligation Bonds Series X through Series Y do not have early redemption provisions.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

WRD General Obligation Bonds consist of the following at June 30:

Fiscal Year of Issue	Series	Fixed Rates	Fiscal Year of Final Maturity	Amounts Outstanding	
				2013	2012
1964	A	0.1%	2014	\$ 4,000	\$ 8,000
1964	B&C	0.05-3.0%	2015	10,000	16,000
1965	D&E	3.0-3.8%	2016	22,100	30,500
1966	F&G	3.5-4.1%	2017	34,600	42,600
1967	H,J&K	3.0-4.8%	2018	59,900	71,700
1968	L&M	4.0-4.9%	2019	50,400	57,800
1970	N&P	5.0-5.8%	2020	57,800	65,000
1971	Q&R	4.8-5.2%	2021	48,750	54,000
1972	S	5.3-5.5%	2022	14,400	15,720
1993	X	4.8%	2024	550	600
1994	Y	7.0-7.1%	2025	420	455
Total General Obligation bonds debt outstanding at par				302,920	362,375
Less current maturities				(61,085)	(59,455)
Total Long term General Obligation bonds debt outstanding				<u>\$ 241,835</u>	<u>\$ 302,920</u>

Revenue Bonds

The Central Valley Project Water System (CVP) Revenue Bonds have been issued for the acquisition or construction of projects to provide water and power for the SWP. Under the statute pursuant to which CVP Revenue Bonds are issued, principal of and interest on the bonds are secured by and payable solely from revenues attributable to the facilities financed by the bonds, primarily certain payments under the water supply contracts between the System and Water Contractors.

As of June 30, 2013, the amount of the revenues pledged to repay the (CVP) Revenue Bonds debt service is \$3,457,799 with payments through 2036. Principal and interest paid for the current year were \$222,958 and Central Valley Project Act water supply operating revenues were \$297,133. As of June 30, 2012, the amount of the revenues pledged to repay the (CVP) Revenue Bonds debt service were \$3,441,169 with payments through 2036. Principal and Interest paid for the year were \$229,011 and Central Valley Project Act water supply operating revenues were \$307,438.

The System is subject to certain bond covenants, the most restrictive of which requires that the revenues in each year shall be at least equal to 1.25 times the debt service payable from revenues on all bonds outstanding in such year, plus operating costs, and the required funding of a debt service reserve account. The bonds are limited special obligations of the System; neither the principal nor any interest thereon constitutes a debt of the State. Certain of the bonds are redeemable prior to maturity at a redemption price of 100%.

State Water Resources Development System
Notes to Financial Statements
For the years ended June 30, 2013 and 2012

(in thousands)

CVP Revenue Bonds consist of the following at June 30:

Fiscal Year of Issue	Series	Fixed Rates	Fiscal Year of Final Maturity	Fiscal Year of First Call Date	Amounts Outstanding	
					2013	2012
Devil Canyon-Castaic Facilities:						
1973	A&B	5.3-5.4%	2023	1983	\$ 68,070	\$ 72,945
CVP Water System:						
1992	J	7.0%	2013	2001	-	27,720
1999	V	6.3%	2025	None	20,235	20,235
2001	W	5.5%	2015	2012	47,460	48,845
2002	X	5.0-5.5%	2018	None	57,625	119,290
2003	Y	5.0-5.3%	2026	2013	-	160,305
2003	Z	3.3-5.0%	2020	2013	-	82,550
2003	AA	5.0%	2024	2013	-	69,630
2005	AC	3.5-5.0%	2015	2015	29,440	222,110
2006	AD	3.4-3.5%	2015	2015	965	107,515
2008	AE	3.0-5.0%	2030	2018	559,190	577,790
2009	AF	3.0-5.0%	2033	2019	193,515	221,860
2010	AG	3.0-5.0%	2033	2020	168,480	168,800
2011	AH	3.0-5.3%	2036	2021	96,010	97,675
2012	AI	5.0%	2030	2022	92,275	92,275
2012	AJ	3.0-5.0%	2036	2022	216,930	216,930
2012	AK	2.0-5.0%	2036	2022	36,370	36,370
2013	AL	5.0%	2030	2023	105,875	-
2013	AM	5.0%	2026	2023	183,960	-
2013	AN	2.0-5.0%	2036	2023	49,525	-
2013	AO	0.7-3.5%	2030	None	317,505	-
2013	AP	1.0-5.0%	2036	2023	45,340	-
2013	AQ	4.0-5.0%	2036	2023	120,205	-
Total revenue bond debt outstanding at par					2,408,975	2,342,845
Net Unamortized bond issuance premiums/discounts					185,484	144,892
Current fiscal maturities					(114,775)	(124,155)
Total long term bond debt outstanding					<u>\$2,479,684</u>	<u>\$2,363,582</u>

Note: The line "Net Deferred Amount on Refunding" has been removed due to the implementation of GASB Statement No. 65.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

Future Debt Service Requirements

Future principal and interest payment requirements on the bonds are as follows at June 30, 2013:

Year	General Obligation Bonds		Revenue Bonds		Total
	Principal	Interest	Principal	Interest	
2014	\$ 61,085	\$ 12,503	\$ 114,775	\$ 105,679	\$ 294,042
2015	56,875	10,098	115,580	100,234	282,787
2016	49,915	7,742	130,855	95,092	283,604
2017	46,745	5,661	135,115	89,746	277,267
2018	34,235	3,792	139,405	83,848	261,280
2019-2023	53,945	4,446	677,290	334,613	1,070,294
2024-2028	120	6	640,940	182,506	823,572
2029-2033	-	-	354,665	50,296	404,961
2034-2036	-	-	100,350	6,810	107,160
	<u>\$ 302,920</u>	<u>\$ 44,248</u>	<u>\$ 2,408,975</u>	<u>\$ 1,048,824</u>	<u>\$ 3,804,967</u>

Pooled Money Investment Loan (PMIA)

The System applied for and received a loan from the Pooled Money Investment Account pursuant to Government Code section 16313 for \$29.6 million. The proceeds of the loan were used to establish escrow accounts that defeased certain Water System Revenue Bonds that financed recreation, fish, and wildlife enhancement related cost of the acquisition and construction of the System. The loan is to be repaid with surplus revenues of the System made available under Water Code section 12937(b)(4). DWR executed the Pooled Money Investment Board Loan on March 26, 2008. The loan agreement requires minimum quarterly payments of \$1 million on the first day of every March, June, September and December; the first payment was made on September 1, 2008. Interest is computed on the unpaid principal balance of the loan at the Variable Rate on the basis of a 360-day year or twelve 30-day months and the number of days elapsed. The Variable Rate means (a) for the period from the date of the Loan Agreement, March 26, 2008, through and including the day before the first Reset Date (March 25, 2009), five percent per annum, and (b) for each Renewal Period thereafter, the greater of (i) five percent per annum, or (ii) the last available daily rate of return by the PMIA on the day before the Reset Date on which such Renewal Period commences.

State Water Resources Development System

Notes to Financial Statements

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(in thousands)

The minimum future principal and interest payment requirements on the PMIA loan are as follows at June 30, 2013:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2014	\$ 3,317	\$ 683	\$ 4,000
2015	3,486	514	4,000
2016	3,663	337	4,000
2017	3,850	150	4,000
2018	580	7	587
	<u>\$ 14,896</u>	<u>\$ 1,691</u>	<u>\$ 16,587</u>

Commercial Paper Notes

The System has a commercial paper borrowing program of up to \$139,668. Under this program, the System may issue commercial paper at prevailing interest rates for periods of not more than 270 days from the date of issuance. To provide liquidity for the programs, the System entered into a revolving credit agreement with a commercial bank equal to the authorized amount of commercial paper. Under the credit agreement dated October 1, 2011, the bank has agreed to make advances to the System if necessary, to provide moneys for the payment of the commercial paper notes. The bank is obligated to provide \$150,000 with the principal amount of commercial paper notes limited to \$139,668 and \$10,332 of accrued interest, calculated for sizing purposes at 10% per annum for 270 days on a maximum principal commitment of \$139,668. The Line of Credit is scheduled to expire on October 24, 2014 but can be extended for up to three years upon written request and approval of the bank. The credit agreement requires quarterly payments the first day of July and October and on the last day of December and March. As of June 30, 2013, there were no borrowings with the bank under the credit agreement. At June 30, 2013 and 2012, there were commercial paper borrowings of \$50,505 and \$28,783, respectively, outstanding under this program. The weighted average for interest expense approximated 0.16% and 0.18% for the years ended June 30, 2013, and 2012, respectively. The proceeds from the issuance of commercial paper are restricted to construction costs of certain State water projects, reimbursements of construction costs of certain State water projects, and interest and issuance costs of the commercial paper notes. The liability has been classified as long-term as it is the System's policy to redeem the commercial paper outstanding with the issuance of CVP Revenue Bonds. The System's obligation to make debt service payments on the commercial paper notes is subordinate to its payment obligations under the resolutions for the CVP Revenue Bonds and WRD General Obligation Bonds.

The water supply contracts in their original form provide for two charges to the Water Contractors: (a) a Delta Water Charge and (b) a Transportation Charge. These charges are computed so as to return to the State the costs of the facilities necessary to deliver water to the Water Contractors, including capital costs (with interest) and operation and maintenance costs, and expressly including in the case of the facilities to be financed with commercial paper and the related Water System Revenue Bonds, debt service and 1.25 debt service coverage requirements to be satisfied from revenues. DWR expects to redeem its commercial paper liability with proceeds of the additional commercial paper draws until DWR issues Water System Revenue Bonds to provide permanent financing for those Water System Projects financed with commercial paper.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

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7. Bond Refundings and Defeasances

The System has issued CVP Water System Revenue Refunding Bonds to refund various issues of CVP Water System Revenue Bonds previously issued. The net proceeds from these sales were used to purchase State and Local Government Series Securities (SLGS) and U.S. Treasury securities that were deposited in irrevocable escrow trust accounts with an escrow agent as an independent fiscal agent to provide for all future debt service on the bonds being refunded. As a result, those bonds are considered to be defeased and the related liabilities have been excluded from the System's basic financial statements. At June 30, 2013 and 2012, outstanding CVP Water System Revenue Bonds of \$315,265 and \$58,705, respectively, are considered to be defeased.

Refunding and defeasance transactions during fiscal 2013 were as follows:

- On September 5, 2012, the System issued \$105,875 of CVP Water System Revenue Bonds Series AL with an average yield on the bonds of 2.33% to refund \$61,665 of CVP Water System Revenue Bonds Series X, and \$60,280 of CVP Water System Revenue Bonds Series Z. The bond proceeds of \$105,875 and \$18,176, par and premium respectively along with System funds on hand in the amount of \$1,466 were used to refund \$121,945 of bonds, fund \$2,982 of future interest on the defeased bonds, and cover costs of issuance of \$590.
- On September 27, 2012, the System issued \$49,525 of CVP Water System Revenue Bonds Series AN with an average yield on the bonds of 2.98% to refund \$12,550 of CVP Water System Revenue Bonds Series AD. The bond proceeds of \$49,525 and \$10,113, par and premium, respectively, along with System funds on hand in the amount of \$211 were used to refund \$12,550 of bonds, fund \$1,772 of future interest on the defeased bonds, redeem commercial paper borrowings of \$44,807, fund capitalized interest of \$318, fund deposits to the debt service reserve account of \$159, and cover costs of issuance of \$243.
- On September 27, 2012, the System also issued \$317,505 CVP Water System federally-taxable Revenue Bonds Series AO with an average yield on the bonds of 2.54% to refund \$192,250 of CVP Water System Revenue Bonds Series AC, and \$93,540 of CVP Water System Revenue Bonds Series AD. The bond proceeds of \$317,505 along with System funds on hand in the amount of \$5,331 were used to refund \$285,790 of bonds, fund \$35,619 of future interest on the defeased bonds, and cover costs of issuance of \$1,427.
- On March 5, 2013, the System issued \$183,960 of CVP Water System Revenue Bonds Series AM with an average yield on the bonds of 2.71% to refund \$69,630 of CVP Water System Revenue Bonds Series AA, and \$142,210 of CVP Water System Revenue Bonds Series Y. The bond proceeds of \$183,960 and \$29,917, par and premium respectively along with System funds on hand in the amount of \$4,382 were used to refund \$211,840 of bonds, fund \$5,409 of future interest on the defeased bonds, and cover costs of issuance of \$1,010.

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Refunding and defeasance transactions during fiscal 2012 were as follows:

- On September 7, 2011, the System issued \$92,275 of CVP Water System Revenue Bonds Series AI with an average yield on the bonds of 3.06% to refund \$103,200 of CVP Water System Revenue Bonds Series W. The bond proceeds of \$92,275 and \$12,549, par and premium respectively along with System funds on hand in the amount of \$1,806 were used to refund \$103,200 of bonds, fund \$2,742 of future interest on the defeased bonds, and cover costs of issuance of \$688.
- On October 13, 2011, the System issued \$216,930 of CVP Water System Revenue Bonds Series AJ with an average yield on the bonds of 3.13% to retire \$2,850 of CVP Water System Revenue Bonds Series X, \$74,495 of CVP Water System Revenue Bonds Series Y, \$6,730 of CVP Water System Revenue Bonds Series Z, \$37,585 of CVP Water System Revenue Bonds Series AA, \$32,010 of CVP Water System Revenue Bonds Series AC, and \$1,560 of CVP Water System Revenue Bonds Series AD. The System caused an Invitation to Tender Bonds, dated September 14, 2011, to be distributed to the holders of the Refunded Bonds (the "Solicitation") and pursuant to the Solicitation, the System purchased the Refunded Bonds to achieve debt service savings. The respective purchase prices for the Refunded Bonds the System elected to purchase were determined pursuant to the terms of the Solicitation and such purchase prices were paid from proceeds of the Series AJ Bonds on October 14, 2011. Upon purchase, the Refunded Bonds were promptly surrendered to the State Treasurer for cancellation in accordance with the CVP Water System Revenue Bonds General Bond Resolution. The bond proceeds of \$216,930 and \$30,448, par and premium respectively along with System funds on hand in the amount of \$3,122 were used to retire \$155,230 of bonds, fund \$18,958 for redemption premium and accrued interest on the retired bonds, redeem commercial paper borrowings of \$69,322, fund capitalized interest of \$3,719, fund deposits to the debt service reserve account of \$1,641, and cover costs of issuance of \$1,630.
- On March 13, 2012, the System issued \$36,370 of CVP Water System Revenue Bonds Series AK with an average yield on the bonds of 3.05% to refund \$410 of CVP Water System Revenue Bonds Series X, and \$7,946 of CVP Water System Revenue Bonds Series AC. The bond proceeds of \$36,370 and \$6,678, par and premium respectively, along with System funds on hand in the amount of \$125 were used to refund \$8,355 of bonds, fund \$1,131 of future interest on the defeased bonds, redeem commercial paper borrowings of \$32,035, fund capitalized interest of \$903, fund deposits to the debt service reserve account of \$451, and cover costs of issuance of \$298.

These refundings and defeasances were accomplished to take advantage of lower interest rates. The transactions resulted in cash flow savings of \$92,583 and \$34,049 and economic gains (difference between the present values of the debt service payments on the old debt and new debt) of \$76,951 and \$25,480 for fiscal years 2013 and 2012, respectively. The difference between the book value of the old debt and the amount required to retire the debt is deferred and amortized over the original remaining life of the old debt or the life of the new debt, whichever is less.

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Due to implementation of GASB Statement No. 65 the cost of issuance was eliminated (see Notes to Financial Statements, Summary of Significant Accounting Policies). In fiscal years 2013 and 2012, approximately \$84,756 and \$35,647 of cost were deferred. Amortization of all deferred refunding costs was approximately \$20,546 and \$4,526 in fiscal years 2013 and 2012, respectively.

8. Retirement Plan

Plan Description

The State is a member of the California Public Employees' Retirement System (PERS), an agent multiple-employer pension system which provides a contributory defined-benefit pension for substantially all State employees. The System is included in the State Miscellaneous Category (Tier 1 and Tier 2) within PERS. PERS functions as an investment and administrative agent for participating public agencies within the State of California. Departments and agencies within the State of California, including the System, are in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies. Copies of PERS' comprehensive annual financial report may be obtained from their executive office at 400 P Street, Sacramento, California 95814.

The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon employee's years of credited service, age and final compensation. Vesting occurs after five years of credited service except for second tier benefits, which require ten years of credited service. Employees who retire at or after age 50 with five or more years of service are entitled to a retirement benefit, payable monthly for the remainder of their lives. Several survivor benefit options that reduce a retiree's unmodified benefit are available. Benefit provisions and all other requirements are established by State statute.

Funding Policy

Active members who participate in Social Security under the State Miscellaneous Tier 1 category are required to contribute 5% of their annual covered salary after excluding the first \$513 of gross monthly pay. Active members who do not participate in Social Security under the State Miscellaneous Tier 1 category are required to contribute 6% of their annual covered salary after excluding the first \$317 of gross monthly pay. Active members who participate in Social Security under the State Miscellaneous Tier 2 category are not required to make contributions to PERS.

The System is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the PERS Board of Administration. The required employer contribution rate for the fiscal year ended June 30, 2013, were 20.503% and 20.457% for State Miscellaneous Tiers 1 and 2 respectively. For the fiscal year ended June 30, 2012, the required employer contribution rate for Tiers 1 and 2 were 18.175% and 17.025% respectively. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by PERS.

Annual Pension Cost

For the years ended June 30, 2013 and 2012, the System's annual pension cost and actual contribution amounted to approximately \$28 million and \$25 million, respectively. Annual covered payroll is not available for the System. However the actuarially determined contributions for the years ended June 30, 2013 and 2012, approximated the same 1.3% of

State Water Resources Development System

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the total actuarially determined contribution requirements for the State Miscellaneous Category and approximately 17.66% and 15.84%, respectively, of the total System payroll. The required contribution for the year ended June 30, 2013 was determined as part of the June 30, 2011, actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percentage of covered payroll. Likewise, the required contribution for the year ended June 30, 2012 was determined as part of the June 30, 2010, actuarial valuation.

Trend information for the last three years regarding the System's required contributions and the percentage contributed, is as follows:

Three-year Trend Information

Year Ended June 30,	Required Contribution	Percentage of Required Contribution Contributed
2011	\$ 23,013	100%
2012	24,895	100%
2013	28,178	100%

9. Postemployment Benefits Other Than Pensions

The State provides health care and dental benefits to annuitants of the retirement systems to which the State contributes as an employer. To be eligible for these benefits, first-tier plan annuitants must retire on or after age 50 with at least five years of service, and second-tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. In accordance with the California Government Code, the State generally pays 100% of the health insurance cost for annuitants, plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the California Government Code does not specify the State's contribution toward dental insurance costs, the State generally pays all or a portion of the dental insurance cost for annuitants, depending upon the completed years of credited state service at retirement and the dental coverage selected by the annuitant. The System participates in the State's plan on a cost sharing basis. The System recognizes the costs of providing health and dental insurance to annuitants based on the required contribution, which is actuarially determined, and is funded on a pay-as-you-go basis.

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The System's required contributions and resulting net OPEB obligation is as follows:

	<u>2013</u>	<u>2012</u>
Annual required contribution (ARC)	\$ 34,166	\$ 30,732
Interest on net OPEB obligation	4,046	2,922
Adjustment to the ARC	(3,549)	(2,563)
Annual OPEB cost	<u>34,663</u>	<u>31,091</u>
Contributions made	<u>(12,117)</u>	<u>(11,065)</u>
Increase in net OPEB obligation	22,546	20,026
Net OPEB obligation - beginning of year	117,924	97,898
Net OPEB obligation - end of year	<u>\$ 140,470</u>	<u>\$ 117,924</u>

The System's annual required contribution, percentage of the ARC contributed to the plan, and the net OPEB obligation for the fiscal years ended June 30, 2013, 2012 and 2011, were as follows:

<u>Fiscal Year Ended</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>	<u>Net OPEB Obligation</u>
6/30/2011	\$ 41,382	37%	\$ 97,898
6/30/2012	30,732	36%	117,924
6/30/2013	34,116	35%	140,470

The annual OPEB cost (AOC) recorded by the System is calculated by the State and represents an allocation of the total ARC of the State, adjusted for interest and other adjustments. The allocation of retiree health benefit costs is based on the number of active employees funded by the System in relation to the total Department retiree health benefits costs.

The actuarial valuation report for OPEB may be obtained by writing to the Office of State Controller John Chiang, P.O. Box 942850, Sacramento, CA 94250 or by visiting the State Controller's Web site at www.SCO.ca.gov. The System's ARC, AOC and Net OPEB obligation will be calculated and adjusted for on an annual basis.

10. Commitments and Contingencies

Commitments

Construction

The System has entered into long-term construction contract commitments for the State Water Project facilities. The remaining value of contracts in process as of June 30, 2013 and June 30, 2012, approximated \$75,641 and \$65,544, respectively.

Power Transmission and Purchase

The System has long-term power transmission service contracts with anticipated future payments of approximately \$78,754 over periods ranging from one to 29 years. Payments made under these contracts approximated \$13,725 and \$16,984 for the years ended June 30, 2013 and 2012, respectively.

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The System has also entered into long-term power purchase contracts with anticipated future payments of approximately \$478,425 over periods ranging from one to 29 years. Payments made under these contracts, excluding payments to the Kings River Conservation District (District) to cover debt service, approximated \$35,391 and \$48,051 for the years ended June 30, 2013 and 2012, respectively.

The remaining amounts of fixed obligations under the long-term power purchase and transmission contracts as of June 30, 2013, are as follows:

<u>For the year ended</u>	<u>Fixed Obligations</u>
2014	\$ 52,334
2015	46,075
2016	24,093
2017	24,093
2018	24,093
2019 - 2042	386,492
	<u>\$ 557,180</u>

The System has a contract with the District that provides that the System receive all power generated by the Pine Flat Power Plant Project (Project). Under the contract, the System is obligated to pay fixed amounts each year to cover the debt service on bonds issued by the District to build the Project, operations and maintenance expenses, and a charge for power supplied. Such payments are to be made until all of the bonds issued by the District to finance the Project have been retired in 2019. Payments to the District totaled approximately \$10,635 and \$14,500 during the years ended June 30, 2013 and 2012, respectively.

The amounts of fixed obligations of the System related to future principal and interest payments of the District's bonds as of June 30, 2013 are as follows:

<u>For the year ended</u>	<u>Fixed Obligations</u>
2014	\$ 4,302
2015	4,272
2016	4,270
2017	4,253
2018	4,239
2019	4,257
	<u>\$ 25,593</u>

DWR entered into a Power Agreement with the Northern California Power Agency (NCPA) and other project participants on May 24, 2010 to participate in the Lodi Energy Center Project (LEC Project), which consists of a 296 megawatt natural gas-fired combined cycle power plant constructed by NCPA in Lodi, California. The terms of the agreement provide that DWR paid for 33.5 percent of the construction costs, pays 33.5 percent of operating

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costs, and receives 33.5 percent of the power output of the LEC Project on a long term basis. Participation in the LEC Project assists DWR in meeting State Water Project energy requirements, including the replacement of a portion of the energy previously provided by the Reid Gardner Project. NCPA issued revenue bonds on June 24, 2010 for the DWR's share of construction costs. Construction of the LEC Project commenced in early August 2010 with Commercial Operation Date occurring on November 27, 2012. The LEC is one of the most efficient thermal generating units in California and will be economically dispatched before other older gas-fired units, resulting in power revenues that are sufficient to cover the operational costs and a portion of DWR's debt service on the bonds.

The amounts of fixed obligations of the System related to future principal and interest payments of the LEC's bonds as of June 30, 2013 are as follows:

<u>For the year ended</u>	<u>Fixed Obligations</u>
2014	\$ 9,131
2015	9,207
2016	9,209
2017	9,206
2018	9,208
2019 - 2023	46,041
2024 - 2028	46,042
2029 - 2033	46,038
2034 - 2035	18,417
	<u>\$ 202,499</u>

Market value information for certain purchase power, sale and exchange contracts are disclosed at June 30, 2013, using forward market prices discounted at the prevailing risk-free interest rate. All fifteen sales contracts extending beyond June 30, 2013 expire in fiscal 2014. There are thirteen purchase contracts that will expire in fiscal 2014, three purchase contracts will expire in fiscal 2015, six purchase contracts will expire in fiscal 2016, six purchase contracts will expire in fiscal 2017, one purchase contract will expire in fiscal 2018, and one will expire in fiscal 2035. The long-term energy purchase contracts involve energy delivered from the Reid Gardner Project will expire July 30, 2013 and Pine Flat Power Plants expire in 2037, respectively, and a contract with the Metropolitan Water District of Southern California (Metropolitan), one of the Water Contractors, expires in 2019. An agreement with the NCPA, operator of the LEC which commits DWR to purchase power on a long term basis subject to the agreement, has no explicit termination date. Fair value of purchase power and sales commitments extending beyond June 30, 2013 are as follows:

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	<u>Number of Contracts</u>	<u>Total Capacity (MWh)</u>	<u>Fair Value at June 30, 2013</u>
Energy sales	15	450	\$ -
Energy purchases	30	1,054	(34)
Long-term energy purchases	4	544	106
Total			<u>\$ 72</u>

Contingencies

Litigation and Claims

Monterey Amendment

In 1994, the System and certain Water Contractors adopted a set of principles pursuant to which additional amendments to the water supply contracts have since been negotiated (Monterey Amendment). The Monterey Amendment includes provisions related to the transfer of land and related assets, known as the Kern Water Bank, to the Kern County Water Agency (KCWA) (one of the Water Contractors), the operation of certain System reservoirs, transfers of water allocations between contractors, establishment of certain operating reserves, and the revision of calculating certain Water Contractor billings. The Monterey Amendment has been executed by the System and 27 of the 29 Water Contractors, who receive approximately 99% of water delivered annually and who pay approximately 99% of annual water supply revenue. Certain parties have disputed the Monterey Amendment by challenging the validity of the related environmental impact report (EIR). While the courts have allowed the System to proceed with the implementation of the Monterey Amendment, the System was required to prepare a new EIR. DWR completed the new Final EIR in February 2010 and filed its Notice of Determination in May 2010. In June 2010, two Delta water agencies and several environmental organizations and individuals filed a lawsuit in Sacramento Superior Court challenging DWR's California Environmental Quality Act (CEQA) compliance and the validity of the Monterey Amendment, including DWR's transfer of the Kern Fan Element to the KCWA. In July 2010, the same plaintiffs in the Sacramento Superior Court case filed a lawsuit in Kern County Superior Court challenging the transfer of the Kern Fan Element from KCWA to the Kern Water Bank Authority, a local joint powers agency which now has responsibility for the management of the Kern Fan Element and Kern Water Bank. In addition, in June 2010, two water districts in Kern County filed a separate lawsuit in Kern County Superior Court, primarily challenging DWR's CEQA compliance with respect to the Kern Fan Element transfer from DWR to KCWA. The two lawsuits filed in Kern County Superior Court have been transferred to the Sacramento Superior Court. In December 2012, DWR prevailed on its challenge to the plaintiffs' validation causes of action (including the validity of the Kern Fan Element transfer) on the grounds that they were not timely filed. This leaves only the plaintiffs' CEQA compliance challenge, unless the plaintiffs appeal and are successful in their appeal to reinstate the validation causes of action. All three cases are in the pre-trial stage. The System, however, does not believe that there would be any material adverse impact on the System's financial position or results from operations, even if these lawsuits are successful.

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2005 Contractor Lawsuit Regarding Oroville Power Credits

In April, 2005 the Kern County Water Agency and thirteen other Water Contractors filed a lawsuit against the System in Sacramento County Superior Court for declaratory relief and breach of contract. The complaint alleges that pursuant to the water supply contracts, the System is required, but failed, to credit all revenues from power generated by certain project conservation facilities (primarily the Hyatt-Thermalito Power Plants) to the Delta Water charge in the Water Contractor billings, and, as a result, was overcharging the Water Contractor plaintiffs. The complaint seeks a declaration that all "benefits" derived from the sale or other disposal of power from project conservation facilities be credited "in conformity with the terms of the water supply contracts," along with damages and costs in an unspecified amount. The Metropolitan Water District of Southern California and entities representing 12 other southern Water Contractors received court permission in December, 2005 to intervene in the lawsuit as defendants. Plaintiffs thereafter filed an amended complaint joining two additional contractors. A non-jury trial was held in November and December 2008. In May 2010, the Court entered its judgment in favor of DWR and the Water Contractors which intervened in support of DWR, finding that DWR's determinations and administration of the provisions regarding Oroville power credits were consistent with the water supply contracts. The Water Contractor plaintiffs appealed the lower court's decision to the Court of Appeal and in February 2013 the Court of Appeal issued its decision upholding the judgment of the trial court in favor of DWR and the intervening Water Contractors. The plaintiffs did not seek any further review of the case, so the case is now concluded.

Other Claims by Water Contractors, Including Claims Concerning Charges for Recreation and Fish and Wildlife Enhancement

In accordance with the water supply contracts, in December 2005, 27 Water Contractors and entities representing Water Contractors filed "Notices of Contest" with the System challenging the accuracy of various charges in the System's billings. One Water Contractor also filed a claim based on its Notice of Contest with the Victim Compensation and Government Claims Board. The System has been reviewing these Notices of Contest and investigating the items raised.

One item that has been determined to have merit, contested the System's practice of charging the Water Contractors for certain financing costs of the recreation and fish and wildlife enhancement portion of facilities financed with Water System Revenue Bonds. The System rectified the situation by restating past bills to provide appropriate credits back to the Water Contractors for the contested charges and taking other actions to pay for the costs of the recreation and fish and wildlife enhancement portion of System facilities with sources other than direct charges to the Water Contractors. Such actions included obtaining a loan from the State Pooled Money Investment Account (PMIA) in the amount of \$29.6 million, which was used together with certain other available funds to retire or provide for the defeasance of approximately \$28.2 million principal amount of revenue bonds and commercial paper notes, the proceeds of which had been used to pay costs allocated by the System to the development of recreation or fish and wildlife enhancement. The System has agreed to pay a minimum of \$4 million per year to repay the PMIA loan.

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With the receipt of the PMIA loan and the waivers in the 2007 and 2008 Tolling and Waiver Agreement obtained from the 27 Water Contractors who signed the Monterey Amendment, the System sold revenue bonds in May 2008. The sale of System revenue bonds had been suspended pending the resolution of the recreation and fish and wildlife enhancement issue.

In addition to waivers included in the 2007 and 2008 Tolling and Waiver Agreements, which helped to facilitate the resumption of the sale of System revenue bonds, the Tolling and Waiver Agreements, as amended, also tolled (i.e. suspended) until December 31, 2015 the running of the time period and statute of limitations for filing by the Water Contractors of (1) protests regarding the System's bills to the Water Contractors for the years 2007 through 2016, (2) claims arising from the System's revisions to prior year invoices that were made to adjust for improper charges to the Water Contractors for recreation and fish and wildlife enhancement costs, and (3) certain other specified claims. The Tolling and Waiver Agreement also tolled the running of the time period for bringing an action on the Victim Compensation and Government Claims Board claim regarding the 2006 invoice that was filed by one of the Water Contractors. In the meantime, the System and Water Contractors are continuing their efforts to resolve issues that are covered by the Tolling and Waiver Agreement. However, no assurance can be given that the Water Contractors will not file additional Notices of Contest, claims and/or lawsuits with respect to the issues under discussion once the Tolling and Waiver Agreements expire.

Lawsuits Regarding 2004 Delta Levee Failure

Four lawsuits have been filed to recover damages caused when a Delta levee failed and flooded the Upper Jones Tract and Lower Jones Tract in June 2004. Three of the lawsuits name as defendants a local Delta reclamation district, the State Reclamation Board and the DWR. A cause of action in each of these three lawsuits alleges that the System's operations and activities in the Delta were a cause of the damage. All four lawsuits were consolidated for trial, although the fourth lawsuit does not involve DWR or any other state agency. Upon completion of the trial, the judge issued a decision in August 2012 in favor of DWR. All the plaintiffs, except for two insurance companies, have appealed the decision. The System does not believe that an adverse court decision in any of these consolidated cases would have a material adverse impact on the System's finances or operations because such costs would be recoverable under the long-term water supply contracts.

General

The System, during the ordinary course of its operations, has been named in a number of additional suits and claims, several of which are still pending.

In the opinions of management and the System's legal counsel, such legal actions will not have a material effect on the System's financial position or results from operations. If incurred, such costs would be recoverable from project beneficiaries under the long-term water supply contracts.

Federal Energy Regulatory Commission Proceedings

There are a number of proceedings pending before the Federal Energy Regulatory Commission (FERC) that may impact the cost of System operations. Some of these proceedings address requests from the California Independent System Operator, investor-owned utilities, and others to increase or adjust rates or allocate responsibility for costs for

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transmission and other services provided to the System and other entities in California. The System is participating in these proceedings, since the outcome of these proceedings has the potential to increase the System's annual power costs. However, the System does not believe that any increased charges arising from these proceedings will materially impact the System's financial position or results from operations. Any increased charges will be passed through to the Water Contractors under the water supply contracts in the form of higher operations charges.

Claims for Partial Energy Purchase Refunds

FERC proceedings have also been instituted to address power purchaser requests for partial refunds from sellers of energy and related services in 2000 and 2001, including the System. However, in September 2005, the United States Ninth Circuit Court of Appeals ruled that FERC lacked jurisdiction under the Federal Power Act to order governmental entities, such as the System, to provide refunds in these types of proceedings. As a result of this Ninth Circuit Court of Appeals' ruling, a group of California entities filed similar claims for partial energy purchase refunds with the California Victim Compensation and Government Claims Board (Claims Board) against the governmental entity sellers, including the System. The claims were denied by the Claims Board in April, 2006, which allows the claimants to file lawsuits against the governmental entity sellers, including the System. However, DWR and a group of California entities have agreed to suspend the running of the statute of limitations for the filing of a lawsuit through February 28, 2014. The System believes that amounts, if any, that the System might be required to refund as a result of these claims would not have a material impact on the System's financial position or results from operations because the impact of any refunds would be passed through to the Water Contractors under the water supply contracts in the form of higher operating charges.

Pollution Remediation

Reid Gardner Power Plant

The Reid Gardner (R-G) Power Plant, located near Moapa, Nevada, is operated by Nevada Energy (NVE) and consists of four coal-powered generators—Units 1 through 4. Units 1–3 are 100% owned by NVE, whereas the capital ownership of Unit 4 is shared between the DWR and NVE at 67.8% and 32.2%, respectively. Additionally, DWR has a 29.2% share of the R-G facilities necessary for and common to all four units. While the DWR ownership percentages cited above are expected to terminate during calendar 2013 and after fiscal 2013, the potential remediation liability described below is expected to be shared under an agreement between NVE and DWR that is expected to be executed during calendar 2013.

In February 2008, NVE entered into an Administrative Order on Consent (AOC) with the Nevada Division of Environmental Protection (NDEP). Pursuant to the AOC, NVE agreed to undertake investigatory activities into various potential areas of contamination at R-G and also to ultimately remediate groundwater, soils, and other contamination at the R-G facility. Groundwater and soils have been affected by certain chemicals of interest associated with flue gas desulfurization effluent settlement and evaporation ponds. Since some of this contamination can be associated with the Unit No. 4 generation related facilities such as the evaporation ponds, DWR, as co-owner of Unit No. 4, has agreed to share the cost of NVE's investigatory activities, which will ultimately lead to the remediation measures prescribed by NDEP to NVE. These activities are projected to continue through at least 2023.

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Based on a review of NVE's ongoing and planned investigations and overall AOC planning activities, DWR's estimated equitable share of the current value of outlays could range between \$12 million and \$24 million; a quantitative estimate of the ultimate investigatory and remediation cost is difficult at this time, as baseline conditions are still being assessed by NDEP. DWR's current estimate is based upon a quantitative assessment of constituents of concern currently known to DWR applied to a range of potential and applicable remediation strategies. DWR calculated the potential financial liability by estimating a reasonable range of potential outlays and applying an estimated probability of occurrence to the potential outlays, yielding a current total expected liability of \$23.5 million. The System expended approximately \$74 in FY 2012/2013 and DWR expects to pay \$7.5 million of the total estimated liability during FY 2013/2014. The total remediation outlay estimate is expected to be refined, and adjusted accordingly, as additional site assessment and final remediation disposition information is available to DWR.

Meanwhile, in August 2013, a Native American tribe and an environmental organization filed a lawsuit against NVE and DWR in federal district court in Nevada, claiming violations of federal environmental laws, specifically the Resource Conservation and Recovery Act and the Clean Water Act, related to the asserted contamination of the land, groundwater and surface water, and alleged discharge of pollutants into the nearby Muddy River from the R-G Station. The lawsuit, which relates to some of the same contaminants addressed in the AOC, seeks declaratory and injunctive relief requiring NVE and DWR to conduct studies and undertake cleanup at the site. In March 2012, the same Native American tribe served on NVE and DWR a formal notice of intent to file another lawsuit under the federal Clean Air Act, but no such lawsuit has yet been filed.

Delta Basin Plan: Mercury Control Program

In June 2011, the State Water Resources Control Board adopted an amendment to the Sacramento-San Joaquin Delta Basin Plan regarding the control in the Delta of methylmercury. The amendment, among other things, assigns certain responsibilities jointly to DWR (with regard to both the System and DWR's flood management programs), the Central Valley Flood Protection Board and the State Lands Commission to reduce methylmercury in the open waters of the Delta. In addition, DWR and others are assigned certain responsibilities regarding the discharge of methylmercury from wetland and other aquatic restoration and enhancement projects. The required actions are divided into two phases. Phase I, which lasts for up to nine years until approximately October 2020, emphasizes studies and pilot projects to control methylmercury, along with some implementation, and Phase II requires implementation of measures to achieve required methylmercury levels by 2030. In July 2011, an organization representing 27 Water Contractors filed a lawsuit against the State Water Resources Control Board and the Central Valley Regional Water Quality Control Board (Regional Board) challenging the portion of the Basin Plan amendment that requires DWR, in its capacity as operator of the System, to reduce methylmercury in the open waters of the Delta. DWR was named as a real party in interest in the lawsuit. The Contractors contended that since the System's water management activities do not add or introduce methylmercury into the Delta, there is no basis in law for assigning responsibility to the System to reduce the methylmercury that is present in the open waters of the Delta. The lawsuit was dismissed in early 2013. Under an agreement between the parties, the lawsuit could be re-filed following completion of Phase I studies and the Regional Board's review of initial load allocations.

State Water Resources Development System

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For the years ended June 30, 2013 and 2012

(in thousands)

The Systems' Mercury Control Program (Program) was established in May 2011. The Program was fully staffed at the end of fiscal 2013. DWR has submitted workplans to the Regional Board that outline the studies DWR will undertake in fulfillment of Phase 1 requirements. Acceptance of these workplan activities is pending Regional Board approval. Until the Regional Board accepts the DWR's workplans, it is difficult, at this time, to quantify future Phase 1 expenses. As these uncertainties are resolved, refinement of Program expenses, through the end of the Phase 1 study period will occur.

The System expended approximately \$470 in fiscal 2013. DWR estimates that the System may incur labor costs of up to about \$900 in each of fiscal 2014 and 2015. For fiscal 2013 through 2016, additional analytical and consulting outlays are anticipated and would be covered through the use of available funds outside of the System. Based on the uncertainties outlined above, the System could expect to expend approximately \$900 each year, for the remaining years, through fiscal 2020, with a more accurate estimate of future Phase 1 expenses to be determined in the next several fiscal years as the Program continues to develop. Total expenses from fiscal 2012 through fiscal 2020 are projected at \$6.2 million. At this time, there is not enough information to estimate System outlays for Phase II implementation.

The ultimate amount to be expended by the System will depend, among other things, upon actual DWR expenses associated with Phase I studies and pilot projects, future decisions by the Regional Board on Phase II load allocations, and the distribution of costs among the agencies ultimately determined to be responsible.

11. Self-Insurance

The System is self-insured for all completed facilities of the SWP other than a portion of the Reid Gardner Project. The System is also self-insured for workers' compensation, general liability and other risks. All workers' compensation claims and other losses are on a "pay-as-you-go" basis. The long-term water supply contracts provide for recovery of such losses from the Water Contractors. Additionally, the CVP Act and the related bond resolutions authorize the issuance of additional bonds, payable from available revenues or federal reimbursements under the National Disaster Act, for the purpose of providing funds for emergency repairs to power projects or water system projects necessitated by natural disasters, provided that certain conditions are met.

12. Economic Dependency

The System's water supply revenue is derived from 29 Water Contractors, including the Metropolitan Water District of Southern California whose System billings constituted 54% and 56% of total System water supply revenue for the years ended June 30, 2013 and 2012, respectively, and Kern County Water Agency whose System billings constituted 10% of total System water supply revenue for the years ended June 30, 2013 and 2012.

The System sold power to 18 and 13 power companies during the fiscal years ended June 30, 2013 and 2012, respectively. The highest percentage of power revenues came from the California Independent System Operator. The following table shows power sales to companies which exceeded 5% of the total power sold by the System excluding power sold to the Water Contractors in the amount of \$13.7 million and \$21.6 million, for the years ended June 30, 2013 and 2012, respectively.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

	<u>2013</u>	<u>% Total</u>	<u>2012</u>	<u>% Total</u>
California Independent System Operator	\$ 102,687	67.14%	\$ 73,722	58.16%
Northern California Power Agency	16,541	10.82%	-	-
Morgan Stanley Capital Group Inc.	8,800	5.75%	10,216	8.06%
Constellation Energy Commodities Gr	-	-	15,557	12.27%
Western Area Power Administration	-	-	6,787	5.35%

Similarly, the System purchased power from 21 and 22 power suppliers during the years ended June 30, 2013 and 2012, respectively. The highest percentage of power provided to the System came from the California Independent System Operator. The following table shows power purchases from suppliers which exceeded 5% of the total power purchased by the System.

	<u>2013</u>	<u>% Total</u>	<u>2012</u>	<u>% Total</u>
California Independent System Operator	\$ 141,541	54.67%	\$ 138,257	50.95%
Northern California Power Agency	22,315	10.55%	-	-
Morgan Stanley Capital Group Inc.	35,418	13.68%	40,311	14.85%
JP Morgan Ventures Energy Corp	13,670	5.28%	-	-
Citigroup Energy Inc.	-	-	13,768	5.07%

State Water Resources Development System
Notes to Financial Statements
For the years ended June 30, 2013 and 2012

(in thousands)

13. Segment Information

The table below presents the condensed statements of net position, the statements of revenues, expenses and changes in net position and the statements of cash flows for the System's two segments, as of and for the years ended June 30, 2013 and 2012.

	2013			2012 (as restated)		
	Activities Allowed Under			Activities Allowed Under		
	Burns-Porter Act	Central Valley Project Act	Total	Burns-Porter Act	Central Valley Project Act	Total
Condensed Statements of Net Position:						
Assets						
Capital assets	\$ 890,015	\$ 2,437,950	\$ 3,327,965	\$ 874,474	\$ 2,338,478	\$ 3,212,952
Other assets	593,448	562,733	1,156,181	629,204	551,123	1,180,327
Current assets	295,025	385,521	680,546	248,565	331,212	579,777
Total assets	1,778,488	3,386,204	5,164,692	1,752,243	3,220,813	4,973,056
Deferred outflows of resources	-	124,591	124,591	-	57,930	57,930
Total assets and deferred outflows of resources	\$ 1,778,488	\$ 3,510,795	\$ 5,289,283	\$ 1,752,243	\$ 3,278,743	\$ 5,030,986
Capitalization and Liabilities						
Capitalization:						
Net position:						
Net investment in capital assets	\$ 859,357	\$ (73,897)	\$ 785,460	\$ 781,205	\$ (97,180)	\$ 684,025
Restricted	349,899	70,069	419,968	428,051	93,352	521,403
Total net position	1,209,256	(3,828)	1,205,428	1,209,256	(3,828)	1,205,428
Long-term liabilities	432,497	2,715,578	3,148,075	469,579	2,584,885	3,054,464
Total capitalization	1,641,753	2,711,750	4,353,503	1,678,835	2,581,057	4,259,892
Current liabilities	163,201	301,143	464,344	149,456	328,095	477,551
Total capitalization and liabilities	1,804,954	3,012,893	4,817,847	1,828,291	2,909,152	4,737,443
Deferred inflows of resources	(26,465)	497,901	471,436	(76,048)	369,591	293,543
Total liabilities, deferred inflows of resources and net position	\$ 1,778,489	\$ 3,510,794	\$ 5,289,283	\$ 1,752,243	\$ 3,278,743	\$ 5,030,986
Condensed Statements of Revenues, Expenses and Changes in Net Position:						
Operating revenues:						
Water supply	\$ 634,675	\$ 297,133	\$ 931,808	\$ 553,453	\$ 307,438	\$ 860,891
Power sales	144,704	1,573	146,277	146,220	2,140	148,360
Federal reimbursements	47,207	1,903	49,110	35,490	1,071	36,561
	826,586	300,609	1,127,195	735,163	310,649	1,045,812
Depreciation expense	(22,146)	(63,090)	(85,236)	(22,302)	(65,098)	(87,400)
Other operating expense	(739,006)	(83,631)	(822,637)	(676,109)	(188,733)	(864,842)
Income from operations	65,434	153,888	219,322	36,752	56,818	93,570
Capital revenues (deferred) recovered	(41,947)	(133,058)	(175,005)	10,689	33,145	43,834
Interest expense	(15,402)	(38,090)	(53,492)	(17,783)	(89,987)	(107,770)
Transfers In	8,313	3,314,885	3,323,198	7,543	65,945	73,488
Transfers Out	(17,379)	(3,305,819)	(3,323,198)	(38,326)	(35,162)	(73,488)
Other (expense) income	981	8,194	9,175	1,125	(30,759)	(29,634)
Increase (decrease) in net position	-	-	-	-	-	-
Net position, beginning of year, as restated	1,209,256	(3,828)	1,205,428	1,209,256	(3,828)	1,205,428
Net position, end of year	\$ 1,209,256	\$ (3,828)	\$ 1,205,428	\$ 1,209,256	\$ (3,828)	\$ 1,205,428
Condensed Statements of Cash Flows:						
Net cash provided by (used in):						
Operating activities	\$ 176,847	\$ 202,967	\$ 379,814	\$ 77,071	\$ 195,355	\$ 272,426
Capital and related financing activities	(125,394)	(132,805)	(258,199)	(124,566)	(204,768)	(329,334)
Investing activities	3,481	7,661	11,142	2,944	5,945	8,889
Net (decrease) increase in cash and cash equivalents	54,934	77,823	132,757	(44,551)	(3,468)	(48,019)
Cash and equivalents, beginning of year	199,577	304,125	503,702	244,128	307,593	551,721
Cash and equivalents, end of year	\$ 254,511	\$ 381,948	\$ 636,459	\$ 199,577	\$ 304,125	\$ 503,702

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

14. New Governmental Accounting Standards

GASB Statement No. 60

Effective July 1, 2012, the System implemented GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. This statement addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The implementation of GASB Statement No. 60 during the year ended June 30, 2013, did not have a material effect on the System's financial statements.

GASB Statement No. 61

In November 2010, the GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*. This statement amends GASB Statement No. 14 and GASB Statement No. 34, to modify certain requirements for inclusion of component units in the financial reporting entity, to amend the criteria for reporting component units as if they were part of the primary government in certain circumstances, and clarifies the reporting of equity interests in legally separate organizations. The requirements of GASB No. 61 are effective for fiscal year 2013 and thereafter. It has been determined that GASB No. 61 did not impact the System.

GASB Statement No. 62

Effective July 1, 2012, the System implemented GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The requirements in this Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. The implementation of GASB Statement No. 62, during the year ended June 30, 2013, did not have a material effect on the System's financial statements.

GASB Statement No. 64

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions an amendment of GASB Statement No. 53*. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. The requirements of Statement No. 64 are effective for the System beginning in fiscal 2013. It has been determined that GASB No. 64 did not impact the System.

GASB Statement No. 63 and No. 65

Effective July 1, 2012, the System implemented GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. A summary of the fiscal year 2012 financial statement items restated in connection with the adoption of GASB Statement No. 63 and 65 are shown in the following tables:

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

Statements of Net Position

	Balance previously reported at June 30, 2012	GASB 65 adjustment	June 30, 2012 (as restated)
Total long-term assets			
Amounts recoverable through future billings under long-term water supply contracts:			
Operations and maintenance expense	\$ 27,733	\$ 2,154	\$ 29,887
Capital credit due from water contractors	80,483	2,451	82,934
Deferred outflows of resources			
Deferral of loss on refunding	-	57,930	57,930
Capitalization and Liabilities			
Net Position			
Restricted	521,406	(3)	521,403
Long-term liabilities:			
Revenue bonds	2,303,201	60,381	2,363,582
Deferred inflows of resources			
Operations and maintenance expense	-	2,154	2,154

Statements of Revenues, Expenses and Changes in Net Position

	Balance previously reported for the year ended June 30, 2012	GASB 65 adjustment	Year ended June 30, 2012 (as restated)
Operating expenses			
Operations and maintenance	\$ 523,951	\$ 2,451	\$ 526,402
Operating expense recovered	57,076	9,987	67,063
Nonoperating revenues			
Capital revenue recovered	31,396	12,438	43,834

Due to the implementation of GASB Statement No. 65, certain amounts previously reported by the System as assets and liabilities, as noted in the table above, have been reclassified. The most significant reclassification was related to the deferral of loss on refunding, which was previously reported as a component of the carrying value of the System's revenue bonds, and is now being separately reported as deferred outflows of resources.

State Water Resources Development System

Notes to Financial Statements

For the years ended June 30, 2013 and 2012

(in thousands)

GASB Statement No. 66

In March 2012, the GASB issued Statement No. 66, *Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62*. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The requirements of GASB No. 66 are effective for fiscal year 2014 and thereafter.

GASB Statement No. 68

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. The requirements of GASB No. 68 are effective for fiscal year 2015 and thereafter.

15. Significant Events

In April 2013, The Department published a notice that it would begin negotiations in a public forum with the Water Contractors to develop contract amendments to extend the term and change certain financial provisions of the Water Supply Contracts. The negotiating sessions began in May 2013 and are continuing. Each Water Supply Contract currently has a specific termination date depending upon when the contract was initially executed. The contract termination dates range between 2035 and 2042. Environmental review pursuant to the California Environmental Quality Act (CEQA) will be part of the contract extension process.

On November 22, 2012, the System experienced a fire of the Thermalito-Hyatt Power Plant (THPP) at the Oroville Complex. The fire began on the third level (elevation 136), and spread upwards into the control room on the next floor up. Although the emergency responders attempted to extinguish the fire, it burned out of control for several hours, resulting in considerable damage to the plant. The plant has been 100% unavailable (zero generation) since November 22, 2012. All water deliveries are being made via the single bypass gate.

Since the System is self-insured, permission was secured to authorize issuance of additional bonds for the purpose of providing funds to restore generation and productivity of the plant. Immediately after the fire, an extensive effort was undertaken to clean and decontaminate the plant, make the plant safe, and return essential plant systems. In addition, studies were commissioned to determine the cause and origination of the fire and to assess plant components and provide a cost estimate to return the plant to service. As of June 30, 2013, DWR was still faced with two possible outcomes based on evaluations completed through August 2013. If the plant is determined to be a total loss,

State Water Resources Development System
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For the years ended June 30, 2013 and 2012

(in thousands)

decommissioning plans will need to be made and reliable alternatives to move water from forebay to afterbay will need to be developed.

A Value Engineering Workshop was held August 11 – August 16 to evaluate the options regarding THPP. As a result of the workshop it is evident that the best business case is to return the plant to service. Decommissioning the plant had a very high initial capital cost with no cost recovery provisions. Rebuilding the plant also had a very high initial capital cost but the ability to recover those costs. It is anticipated that restoration activities should commence early in 2014 provided acceptance and approval is secured.

Currently, all costs resulting from the fire approximated \$33.3 million at June 30, 2013, are being considered assessments and recorded in construction work in progress (CWIP). THPP was placed in service in 1973 with an expected useful life of 46 years and capitalized at an initial acquisition cost of \$89.7 million. Pending management evaluation the asset's net book value at June 30, 2013 remains recorded at \$11.8 million. The losses associated with the fire that occurred in 2013 will be recorded after the possible outcomes are assessed and a plan is implemented in year 2014.

Supplementary Information

**State Water Resources Development System
Calculation of Adequacy of Debt Service Coverage for the
Central Valley Project Revenue Bonds
For the years ended June 30, 2013 and 2012**

(in thousands)

	<u>2013</u>	<u>2012</u>
Water supply revenues, Central Valley Project Act	\$ 297,133	\$ 307,438
Add: Cover Collected as Proceeds Due To Water Contractors	54,677	56,385
Less: Devil Canyon Castaic Revenues	(16,763)	(16,979)
Revenues not available for Debt Service	<u>(64,026)</u>	<u>(68,469)</u>
Net CVP revenues available for debt service	<u>271,021</u>	<u>278,375</u>
Principal and interest for revenue bonds	<u>\$ 214,378</u>	<u>\$ 220,455</u>
Debt service coverage	<u>126.4%</u>	<u>126.3%</u>

Note: Section 805 of the general bond resolution for the Central Valley Project (CVP) Water system Revenue Bonds states, "The total amount of Revenues receivable under all Water Supply Contracts in any Year shall be the sum of (A) 1.25 times the Annual Debt Service for such Year to be paid from the Revenue Fund, plus (B) the amount estimated by the Department, pursuant to Section 605, to be required from the Revenue Fund in such Year to provide for Water System Operating Expenses..."

The Supplementary Information, Calculation of Adequacy of Debt Service Coverage for the Central Valley Project (CVP) Revenue Bonds is based on \$297.1 million in fiscal 2013 and \$307.4 million in 2012, respectively in Water Supply Revenues of the System's (CVP) segment. In fiscal 2013, the revenues include: an increase of \$54.7 million in refundable proceeds, a decrease of \$16.8 million for principal and interest payments for the Devil Canyon Castaic Facilities Bonds (DCC) since the DCC General Bond resolution does not require cover to be collected for these bonds, and a decrease of \$64 million of which \$66.6 million is primarily related to operations and maintenance and \$7.4 million is related to miscellaneous revenues not intended for debt service and a \$10 million decrease is related to refund paid to the water contractor .

In fiscal 2012 the revenues include: an increase of \$56.4 million in refundable proceeds, a decrease of \$16.9 million for principal and interest payments for the DCC Facilities Bonds, and a decrease of \$68.5 million, of which \$59.3 million is primarily related to operations and maintenance and \$9.2 million is related to miscellaneous revenues not intended for debt service.

Edmund G. Brown Jr.
Governor, State of California

John Laird
Secretary of Resources,
Natural Resources Agency

Mark Cowin
Director, Department of Water Resources



APPENDIX C

SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION

General Authority

The Bonds are authorized by the provisions of the CVP Act. The Department's authority to issue bonds under the CVP Act was confirmed by a decision of the Supreme Court of California in *Warne v. Harkness*, 60 Cal.2d 579 (1963). The CVP Act and such decision authorize the Department to pledge revenues for the security of CVP Act bonds, free and clear of the pledge of revenues of the State Water Project to the general obligation bonds of the State issued pursuant to the Burns-Porter Act. Under the CVP Act the payment of bond debt service has priority over the payment of operating expenses.

Issuance of Bonds

Additional Bonds may be issued on a parity with outstanding Bonds and secured by an equal lien on the Revenues, to finance or refinance the costs of construction or acquisition of facilities for water conservation or transportation, including facilities to generate or transmit electric power, for the State Water Project ("Water System Projects"), the costs of study or planning of any potential Water System Project ("Project Planning Costs"), and to make deposits to the Debt Service Reserve Account. The issuance of additional Bonds is authorized by the adoption of a supplemental resolution and is subject to certain requirements, including the following:

General Requirements for Additional Bonds. In order to issue a series of additional Bonds, the Department must certify that (a) after the issuance of such Series, estimated Revenues in each year will not be less than the sum of 1.25 times debt service to be paid from the Revenue Fund plus estimated Water System Operating Expenses and (b) the Debt Service Reserve Account is projected to contain on the first interest payment date on which interest for such Series is payable from Revenues, an amount equal to, for any date of calculation, for all Series of Bonds outstanding for which interest is then payable in whole or in part from Revenues, one-half of the maximum Annual Debt Service for the then current Year or any Year after such date of calculation. In addition, the Treasurer must have received evidence that the issuance of the additional Bonds will not result in the lowering of any rating then assigned to any then outstanding Bonds by any nationally recognized rating agency.

Additional Requirements for New Money Bonds. In order to issue a series of Bonds for new money purposes, the Department must (in addition to the foregoing general requirements) also certify that the Water System Project for which such series is being issued can be beneficially used by the Department to assist in the conservation or transportation of water under Water Supply Contracts, that the Water System Project is technically and economically feasible and that moneys, if any, for Project Planning Costs are then required (including an estimate of the amount of moneys required for Project Planning Costs).

Disposition of Revenues

Revenues as defined under the Resolution include:

(c) moneys to be received under the Water Supply Contracts resulting from the construction, acquisition or operation of Water System Projects (but only in the amounts required to meet the rate covenant of the Resolution);

(d) moneys received from any other legally available source that the Department in its discretion determines to be Revenues and so designates in a certificate filed with the Treasurer; and

(e) income from the investment of moneys held in the Revenue Fund pursuant to the Resolution.

Revenues do not include any other income or receipts resulting from the construction, acquisition or operation of a Water System Project other than the income and receipts specified in the immediately preceding clauses (a), (b) and (c).

The Resolution requires the State Controller to establish and maintain the following accounts in the Revenue Fund: the Interest Account, the Principal Retirement Account, the Operating Account, the Debt Service Reserve Account, and the Surplus Account. The State Controller is to allocate to the Operating Account during each Year an amount equal to the amount previously estimated by the Department to be required in such Year for Water System Operating Expenses.

The Resolution requires the State Controller to allocate all Revenues, when received, to these accounts. The allocation is required to be in the following priority: Interest Account, Principal Retirement Account, Operating Account, Debt Service Reserve Account and Surplus Account. The State Controller is to allocate to the Interest Account on or before each interest payment date an amount equal to the interest due on such interest payment date (less amounts then in the Interest Account or the Construction Fund available to pay such interest). The State Controller is to allocate to the Principal Retirement Account on or before each maturity date and sinking fund installment date the sum of (a) the principal amount of any serial Bonds becoming due on such date, plus (b) any sinking fund installments that become due on such date. The State Controller is to maintain separate subaccounts in the Principal Retirement Account for the serial Bonds of each series and for the sinking fund installments of each series of Bonds.

Moneys in the Surplus Account may be applied to any lawful purpose, including transfer to funds not subject to the lien of the Resolution.

Debt Service Reserve Account

A Debt Service Reserve Account is required to be maintained in the State Treasury. On the issuance of each series of Bonds, provision must be made for placing moneys in the Debt Service Reserve Account so that on the first interest payment date when interest on the Bonds of that series is to be paid from Revenues, the Debt Service Reserve Account will contain an amount at least equal to, for any date of calculation, for all Series of Bonds outstanding for which interest is then payable in whole or in part from Revenues, one-half of the maximum Annual Debt Service for the then current Year or any Year after such date of calculation (the "Reserve Account Requirement"). Revenues will be allocated to the Debt Service Reserve Account to the extent necessary, under the priority described under "Disposition of Revenues," so that the amount in the Debt Service Reserve Account will be at least equal to such amount.

The Department, at its option and notwithstanding any contrary provision in the Resolution, may withdraw, in whole or in part, amounts required to be held in the Debt Service Reserve Account upon the deposit of a Reserve Fund Instrument with the Treasurer, as trustee, in a stated amount equal to the amounts so withdrawn. Upon request of the Department or as may be provided in a supplemental resolution, Revenues deposited in the Debt Service Reserve Account shall be used to reimburse draws on any Reserve Fund Instruments therein, but only to the extent that such reimbursement results in a commensurate increase in the amount of available coverage provided under the respective Reserve Fund

Instrument. The amount available to be drawn under any Reserve Fund Instrument on deposit in the Debt Service Reserve Account shall be included in calculating the amount credited to such Account. A Reserve Fund Instrument is a letter of credit, surety bond or other credit facility issued by a provider the unsecured obligations of which, at the time of initial deposit of such facility, are rated not lower than “Aa” by Moody’s and “AA” by S&P, and the deposit of which does result in a withdrawal or downgrading of any rating of the Bonds then in effect.

Moneys in the Debt Service Reserve Account are to be applied, upon the claim of the Treasurer, to make good any deficiency in the Interest Account or the Principal Retirement Account, in that priority.

Any amount in the Debt Service Reserve Account in excess of its requirement may be transferred to any legally permissible fund or account designated by the Department.

Security for Payment of Bonds

Payment of the principal and redemption price of, and interest on, the Bonds is secured by a first and direct charge and lien upon the Revenues and all moneys and securities held and accounts established (except amounts, if any, in any Rebate Account) under the Resolution, by the Department, the State Controller, the Treasurer, or the Paying Agent, subject only to the provisions of the Resolution permitting the payment or the use thereof for the purpose, in the manner, and upon the terms and conditions set forth in the Resolution.

The Department must perform and observe all the obligations and conditions required to be performed and observed by it under the Water Supply Contracts at the times, and in the manner therein prescribed. The Department must diligently enforce its rights under the Water Supply Contracts and must not agree to any amendment to the Water Supply Contracts that would materially adversely affect the security of the Bonds.

The Department must at all times use its best efforts to maintain the Revenues in each year at an amount at least equal to 1.25 times the annual debt service for such year to be paid from the Revenue Fund plus the amount required from the Revenue Fund for Water System Operating Expenses in such year, plus certain amounts required to fund initially the Debt Service Reserve Account.

Investment of Moneys Held Under the Resolution

Moneys held in all accounts other than the Debt Service Reserve Account will be invested under the laws governing the investment of moneys in the State Treasury. Moneys held in the Debt Service Reserve Account shall be invested in obligations of the United States (including trust receipts or certificates evidencing ownership of payments on such obligations), in obligations for which the faith and credit of the United States are pledged for the payment of principal and interest, in certain federal agency securities, in certain state or local government obligations secured by obligations of or guaranteed by the United States or in the Surplus Money Investment Fund operated by the Treasurer.

Certain Covenants

The covenants of the Department contained in the Resolution include the following:

Punctual Payment. The Department will pay or cause to be paid the principal or redemption price of and interest to become due in respect of all Bonds, in strict conformity with the terms of the Bonds and of the Resolution, and it will faithfully observe and perform all of the conditions, covenants, and requirements of the Resolution and all supplemental resolutions and of the Bonds.

Covenant Against Encumbrances, Sale, or Disposition. The Department shall not create, or permit to be created, any mortgage, lien, or pledge on the Revenues equal or prior to the charge or lien of the Resolution, nor sell or otherwise dispose of all or any part of a Water System Project essential to the maintenance of the Revenues, nor enter into any lease or agreement that would materially adversely affect the rights or security of the Bondholders under the Resolution.

Tax Covenants. The Department may include in any supplemental resolution authorizing the issuance of a series of Bonds covenants designed to preserve the tax-exempt status of such series of Bonds, including covenants concerning the rebate of excess investment earnings on moneys held under the Resolution.

Events of Default; Remedies of Bondholders

The Bondholders and the Treasurer, as trustee, acting for the Bondholders shall be entitled to all of the rights and remedies provided in the CVP Act and to all of the rights and remedies otherwise provided or permitted by law.

In the event the Department shall default in the payment of principal or redemption price of any Bond, or in the payment of interest on any Bond, or in the event the Department shall not comply with any of the covenants or agreements contained in the Resolution or the Bonds and such defaults shall have continued for a period of 60 days after written notice thereof shall have been given to the Department by the Treasurer, or to the Department and the Treasurer by the holders of at least 25 percent in principal amount of the outstanding Bonds; then the Treasurer or the holders of at least a majority in principal amount of the outstanding Bonds shall be entitled to declare the principal of all of the outstanding Bonds, and the interest accrued thereon, to be due and payable immediately.

Under any default or other occurrence creating a right in the Treasurer to represent the holders of Bonds, the Treasurer may take such action as he or she may deem appropriate, and shall take such action as shall be specified in a written request of the holders of at least 25 percent in principal amount of the outstanding Bonds and upon the furnishing to the Treasurer of indemnity satisfactory to him or her.

Amendment of the Resolution

The Resolution and the rights and obligations of the Department and the Bondholders may be changed at any time by a supplemental resolution when approved by the holders of 60 percent of the principal amount of the Bonds then outstanding and affected by such change at a meeting of the Bondholders or by the written consent of the Bondholders. Any such consent shall be binding upon the Bondholder giving such consent and on any subsequent Bondholder (whether or not such subsequent Bondholder has notice thereof) unless such consent is revoked in writing by the Bondholder giving such consent or a subsequent Bondholder by filing such revocation with the Treasurer prior to the date the Department mails notice that the consents of the holders of the requisite percentage of Bonds have been obtained.

No change shall be made, without the consent of all Bondholders, (a) in the principal amount or the redemption price of any Bond, the rate of interest thereon, the maturity of the principal thereof or of any installment of interest thereon or (b) in the percentage of the principal amount of Bonds the vote or consent of the holders of which is required to effect any change.

A change may also be made at any time by supplemental resolution, without the consent of any Bondholders, for any one or more of the following:

(a) To add to the covenants of the Department, other covenants, or to surrender any right reserved to the Department;

(b) To cure any ambiguity, defect or inconsistent provision in the Resolution or to make provisions in regard to questions arising under the Resolution as the Department deems necessary and not inconsistent with the Resolution, and which shall not materially adversely affect the interests of the Bondholders;

(c) To provide for the issuance of an additional series of Bonds;

(d) To provide for the issuance of Bonds in coupon form rather than or in addition to registered form. No such change may be materially adverse to the interests of the holders of outstanding Bonds; or

(e) To add such provisions as may be necessary to accommodate such banking, insurance, remarketing and other financial arrangements as may be necessary or desirable to provide additional security for the payment of principal and interest on any one or more series of Bonds or to provide the holders of any one or more series of Bonds the right to tender such Bonds to the Department or to another party for purchase at the times, on the notice and on such other terms as the Department may determine. These arrangements may provide for the reimbursement by the Department, with interest, of moneys advanced by the provider of additional security, the provider of a tender right, the provider of moneys to fund a tender right or anyone performing a related function from the sources available for the payment of Bonds. No such change may be materially adverse to the interests of the holders of outstanding Bonds.

Discharge of Obligations Under the Resolution

The obligations of the Department and the pledge, lien, covenants and agreements of the Department made or provided for in the Resolution will be fully discharged and satisfied as to any Bond and such Bond shall no longer be deemed to be outstanding thereunder, when payments of the principal of and the applicable redemption price, if any, on such Bond, plus interest thereon to the due date thereof, (i) has been made or caused to be made in accordance with the terms thereof or (ii) has been provided for by depositing with the Treasurer in trust for such payment (a) moneys sufficient to make such payments or (b) specified governmental obligations maturing as to principal and interest in such amounts and at such times as will insure the availability of sufficient moneys to make such payments, and, except for the purposes of such payment, such Bond will no longer be secured by or entitled to the benefits of the Resolution; provided that, with respect to Bonds that are to be redeemed or otherwise prepaid prior to the stated maturities thereof, no such deposit will constitute such discharge and satisfaction unless such Bonds have been called or designated for redemption or prepayment in accordance with the provisions thereof and notice of such redemption or prepayment has been given or irrevocable provision has been made for the giving of such notice.

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APPENDIX D

SUMMARY OF CONTINUING DISCLOSURE CERTIFICATE

The Department has executed a Continuing Disclosure Certificate, dated September 27, 2012, and will execute a Supplemental Continuing Disclosure Certificate with respect to the Series AS Bonds at the time of delivery of the Series AS Bonds whereby the terms of the Continuing Disclosure Certificate will be made applicable to such Bonds (the Continuing Disclosure Certificate, as supplemented being referred to as the “Disclosure Certificate”). The following is a summary of the provisions of the Disclosure Certificate. Such summary is qualified by reference to the complete Disclosure Certificate, which is available from the Department.

Definitions

“Annual Report” shall mean the Annual Report filed by the Department as described below under the heading “Annual Reports.”

“Beneficial Owner” shall mean any person who has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds to which the Disclosure Certificate is applicable (including persons holding Bonds through nominees, depositories or other intermediaries).

“Dissemination Agent” shall mean any Dissemination Agent designated in writing by the Department.

“Listed Event” shall mean any of the events listed under the heading “Reporting of Significant Events.”

“MSRB” shall mean the Municipal Securities Rulemaking Board or any other entity designated or authorized by the SEC to receive reports or notices pursuant to the Rule. Until otherwise designated by the MSRB or the SEC, filings with the MSRB are to be made through the Electronic Municipal Market Access (EMMA) website of the MSRB, currently located at <http://emma.msrb.org>.

“Obligated Person” shall mean any person, including the Department, who is either generally or through an enterprise, fund, or account of such person committed by contract or other arrangement to support payment of all, or part of the Bonds to which the Disclosure Certificate is applicable (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities).

“Official Statement” shall mean the respective Official Statements related to the Bonds to which the Disclosure Certificate is applicable.

“Rule” shall mean Rule 15c2-12(b)(5) adopted by the SEC under the Securities Exchange Act of 1934, as the same may be amended from time to time.

“SEC” means the Securities Exchange Commission.

“State” shall mean the State of California.

Annual Reports

The Department shall, or shall cause the Dissemination Agent to, not later than 270 days after the end of the Department's fiscal year (which fiscal year as of the date of the Disclosure Certificate ends June 30), provide an Annual Report consistent with the requirements of the Disclosure Certificate to the MSRB in such form as is required by the MSRB; provided that the audited financial statements of the Department may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the Department's fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event under Section 5(c).

If in any year the Department does not provide, or cause the Dissemination Agent to provide, the Annual Report to the MSRB by the date required under the Disclosure Certificate, the Department shall file notice with the MSRB stating that the Annual Report has not been filed, and if known, the date by which the Department expects to file, or cause to be filed, the Annual Report.

The Department's Annual Report shall contain or include by reference the following:

1. The audited financial statements of the Department for the prior fiscal year, prepared in accordance with generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Governmental Accounting Standards Board. If such audited financial statements are not available by the time the Annual Report is required to be filed pursuant to the Disclosure Certificate, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

2. An update of the following information contained in the Official Statement:

- a. The amount on deposit in the Debt Service Reserve Account.
- b. The information under the heading "THE DEPARTMENT – Investments of Department Moneys."
- c. The information relating to the prior year's water deliveries under the heading "STATE WATER PROJECT WATER SUPPLY– Annual Water Deliveries."
- d. The information relating to the current year's water requests under the heading "STATE WATER PROJECT WATER SUPPLY– Annual Water Deliveries."
- e. The information relating to sources of power for the prior year in the table under the heading "POWER OPERATIONS OF THE STATE WATER PROJECT – Historical Sources of Power for State Water Project Operations."
- f. The information relating to water deliveries for the prior year in the table under the heading "THE CONTRACTORS – Water Deliveries and Contractor Payments – Historical Deliveries of Water From the State Water Project to the Contractors."
- g. The information relating to payments for the prior year in the table under the heading "THE CONTRACTORS – Water Deliveries and Contractor Payments – Historical Deliveries of Water From the State Water Project to the Contractors."

- h. The information relating to the Contractors in APPENDIX A for any Contractor whose payments are expected to be five percent (5%) or more of Revenues attributable to the bonds outstanding under the Resolution.

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues with respect to which the Department is an “obligated person” (as defined by the Rule), which have been filed with the MSRB or the SEC. If the document included by reference is a final Official Statement, it must be available from the MSRB. The Department shall clearly identify each such other document so included by reference.

Reporting of Significant Events

(a) Pursuant to the provisions of the Disclosure Certificate, the Department shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Outstanding Bonds to which the Disclosure Certificate is applicable:

1. principal and interest payment delinquencies;
2. non-payment related defaults, if material;
3. unscheduled draws on the debt service reserves reflecting financial difficulties;
4. unscheduled draws on the credit enhancements reflecting financial difficulties;
5. substitution of the credit or liquidity providers or their failure to perform;
6. adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax status of the Bonds to which the Disclosure Certificate is applicable;
7. modifications to rights of Bondholders, if material;
8. bond calls, if material, and tender offers;
9. defeasances;
10. release, substitution or sale of property securing repayment of the Bonds, if material;
11. rating changes;
12. bankruptcy, insolvency, receivership, or similar event of the Department;
13. the consummation of a merger, consolidation, or acquisition involving an Obligated Person or the sale of all or substantially all of the assets of an Obligated Person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and

14. the appointment of a successor or additional trustee, or the change in the name of a trustee, if material.

(b) Whenever the Department obtains knowledge of the occurrence of a Listed Event, the Department shall as soon as possible, if such Listed Event requires such a determination as set forth in the preceding clause (a), determine if such event would be material under applicable federal securities laws.

(c) The Department shall promptly file a notice electronically to the MSRB in a timely manner, but not in excess of 10 Business Days after the occurrence of a Listed Event, subject to a determination of its materiality, as applicable. Reference is made to the Rule for a discussion of when the Listed Event enumerated in subsection (a)(12) is deemed to have “occurred.”

Termination of Reporting Obligation

The Department’s obligations under the Disclosure Certificate shall terminate upon the legal defeasance (or in the event a portion of the Bonds is legally defeased, with respect to such defeased Bonds), prior redemption or payment in full of all of the Bonds. If the Department’s obligations under the Resolution are assumed in full by some other entity, such person shall be responsible for compliance with the Disclosure Certificate in the same manner as if it were the Department and the Department shall have no further responsibility under the Disclosure Certificate. If such termination or substitution occurs prior to the final maturity of the Bonds, the Department shall give notice of such termination or substitution in the same manner as for a Listed Event.

Dissemination Agent

The Department may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under the Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent.

Amendment; Waiver

The Department may amend or waive any provision of the Disclosure Certificate, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of the Disclosure Certificate dealing with the timing and content of the Annual Report or the giving of notice of Listed Events, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law or change in the identity, nature or status of an Obligated Person with respect to the Bonds to which the Disclosure Certificate is applicable, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds to which the Disclosure Certificate is applicable, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Bondholders of the Bonds to which the Disclosure Certificate is applicable in the same manner as provided in the Resolution for amendments to the Resolution with the consent of Bondholders, or (ii) does not, in the opinion of

nationally recognized bond counsel, materially impair the interests of the Bondholders or Beneficial Owners of the Bonds to which the Disclosure Certificate is applicable.

In the event of any amendment or waiver of a provision of the Disclosure Certificate, the Department shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the Department. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event, and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

Additional Information

Nothing in the Disclosure Certificate prevents the Department from disseminating any other information, using the means of dissemination set forth in the Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by the Disclosure Certificate. If the Department chooses to include any information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is specifically required by the Disclosure Certificate, the Department shall have no obligation under the Disclosure Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Beneficiaries

The Disclosure Certificate shall inure solely to the benefit of the Bondholders and Beneficial Owners from time to time of the Bonds to which the Disclosure Certificate is applicable, and shall create no rights in any other person or entity (except the right of the Treasurer of the State of California, as trustee for the Bonds, or any Bondholder or Beneficial Owner to enforce the provisions of the Disclosure Certificate on behalf of the Bondholders). The Disclosure Certificate is not intended to create any monetary rights on behalf of any person based upon the Rule.

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APPENDIX E

PROPOSED FORM OF OPINION OF ATTORNEY GENERAL

The following form of opinion is expected to be delivered with respect to the Series AS Bonds on the date of issue thereof.

[Issue Date]

\$645,795,000

**State of California Department of Water Resources
Central Valley Project Water System Revenue Bonds
Series AS**

(Final Opinion)

We have acted as the Attorney General of the State of California in connection with the issuance by the State of California Department of Water Resources (the “Department”) of its Central Valley Project Water System Revenue Bonds, Series AS (the “Series AS Bonds”), in the aggregate principal amount of \$645,795,000. The Series AS Bonds are issued pursuant to Part 3 of Division 6 of the Water Code of the State of California, and under a general bond resolution of the Department, adopted as of July 1, 1986, and a supplemental resolution of the Department, adopted as of September 30, 2014 (the general bond resolution and all resolutions supplemental thereto are herein collectively called the “Resolution”). The Series AS Bonds constitute the forty-fifth series of bonds issued under the Resolution (all bonds at any time outstanding under the Resolution being herein collectively called the “Bonds”) and are issued for one or more of the purposes set forth in the Resolution. Capitalized terms used but not otherwise defined herein shall have the meanings ascribed thereto in the Resolution.

In such connection, we have reviewed the Resolution, certifications of the Department, the Treasurer of the State of California and others as to certain factual matters, the opinion of counsel to the Department, and such other documents and matters to the extent we deemed necessary to render the opinions set forth herein. We have assumed, without undertaking to verify, the genuineness of all documents, certifications, opinions and signatures presented to us (whether as originals or as copies); the due and legal execution and delivery thereof by, and validity against, any parties other than the Department; the accuracy of the factual matters represented, warranted or certified in such documents, certificates and opinions; and compliance with all covenants and agreements contained in the Resolution.

Certain agreements, requirements and procedures contained or referred to in the Resolution, the Tax Certificate and other relevant documents may be changed and certain actions (including without limitation, defeasance of Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. No opinion is expressed herein as to any Bond or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than ourselves.

This opinion is issued as of the date hereof. The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof and we disclaim any obligation to update this letter. We assume no obligation to update, revise or supplement this opinion to reflect any such action hereafter taken or not taken, or any facts or circumstances, or any changes in law or in interpretations thereof, that may arise or occur, or for any other

reason. We call attention to the fact that the rights and obligations under the Series AS Bonds and the Resolution and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against the State of California. We express no opinion with respect to any indemnification, contribution, choice of law, choice of forum, choice of venue or waiver or severability provisions contained in the foregoing documents. Finally, we express no opinion as to the accuracy, adequacy or sufficiency of any financial or other information that has been or will be supplied to the purchasers of the Series AS Bonds and we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement dated _____, 2014, or other offering material relating to the Series AS Bonds and express herein no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Series AS Bonds constitute valid and binding limited obligations of the Department, payable only out of the Revenues and moneys and securities held, and accounts established, under the Resolution.

2. The Resolution has been duly and lawfully adopted and is a valid resolution of the Department, enforceable against the Department in accordance with the terms of the Resolution.

3. The Series AS Bonds are secured by a first and direct charge and lien upon the Revenues and all moneys and securities held, and accounts established, under the Resolution (except amounts held in any Rebate Account established under the Resolution), subject only to the provisions of the Resolution permitting the payment or use of such Revenues, moneys, securities and accounts for the purposes, in the manner and upon the terms and conditions set forth in the Resolution. The Series AS Bonds are not secured by any other property or moneys of the Department.

4. The Series AS Bonds do not constitute a debt, liability or obligation of the State of California or of any political subdivision thereof, or a general obligation of the Department. Neither the faith and credit nor the taxing power of the State or any political subdivision thereof is pledged to the payment of the principal of, premium, if any, or interest on the Series AS Bonds. The Department has no taxing power.

Sincerely,

Deputy Attorney General

For _____
Attorney General of the State of California

APPENDIX F

PROPOSED FORM OF OPINION OF BOND COUNSEL

The following form of opinion is expected to be delivered with respect to the Series AS Bonds on the date of issue thereof.

[Issue Date]

**State of California Department of Water Resources
Central Valley Project Water System Revenue Bonds
Series AS**

(Final Opinion)

We have acted as bond counsel to the Department in connection with the issuance by the State of California Department of Water Resources (the “Department”) of its Central Valley Project Water System Revenue Bonds, Series AS (the “Series AS Bonds”), in the aggregate principal amount of \$645,795,000. The Series AS Bonds are issued pursuant to Part 3 of Division 6 of the Water Code of the State of California, and under a general bond resolution of the Department, adopted as of July 1, 1986, and a supplemental resolution of the Department, adopted as of September 30, 2014 (the general bond resolution and all resolutions supplemental thereto are herein collectively called the “Resolution”). The Series AS Bonds constitute the forty-fifth series of bonds issued under the Resolution (all bonds at any time outstanding under the Resolution being herein collectively called the “Bonds”) and are issued for one or more of the purposes set forth in the Resolution. Capitalized terms used but not otherwise defined herein shall have the meanings ascribed thereto in the Resolution.

In such connection, we have reviewed the Resolution, the Tax Certificate of the Department dated October __, 2014, executed in connection with the Series AS Bonds (the “Tax Certificate”), certifications of the Department, the Treasurer of the State of California and others as to certain factual matters and such other documents and matters to the extent we deemed necessary to render the opinions set forth herein. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the Department. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents referred to in this paragraph.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this letter speaks only as of its date and is not intended to, and may not, be relied upon or otherwise used in connection with any such actions, events or matters and we disclaim any obligation to update this letter. Furthermore, we have assumed compliance with all covenants and agreements contained in the Resolution and the Tax Certificate, including, without limitation, covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Series AS Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Series AS Bonds, the Resolution and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, receivership, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors’ rights, to the application of

equitable principles, to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against the State of California. We express no opinion with respect to any indemnification, contribution, liquidated damages, penalty (including any remedy deemed to constitute a penalty), right of set-off, arbitration, choice of law, choice of forum, choice of venue, non-exclusivity of remedies, or waiver or severability provisions contained in the foregoing documents. Our services did not include financial or other non-legal advice. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement dated _____, 2014, or other offering material relating to the Series AS Bonds, and express herein no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Series AS Bonds constitute valid and binding limited obligations of the Department, payable only out of the Revenues and moneys and securities held, and accounts established, under the Resolution.

2. The Resolution has been duly and lawfully adopted, is a valid resolution of the Department and is binding upon the Department in accordance with the terms of the Resolution.

3. The Series AS Bonds are secured by a first and direct charge and lien upon the Revenues and all moneys and securities held, and accounts established, under the Resolution (except amounts held in any Rebate Account established under the Resolution), subject only to the provisions of the Resolution permitting the payment or use of such Revenues, moneys, securities and accounts for the purposes, in the manner and upon the terms and conditions set forth in the Resolution. The Series AS Bonds are not secured by any other property or moneys of the Department.

4. Neither the principal of nor the interest on the Series AS Bonds constitutes a debt, liability or obligation of the State of California or, except as expressly provided in the Resolution, of the Department.

5. Interest on the Series AS Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. Interest on the Series AS Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series AS Bonds.

Very truly yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

per

APPENDIX G

DTC AND BOOK-ENTRY

The Depository Trust Company, New York, New York (“DTC”) will act as securities depository for the Series AS Bonds. The Series AS Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Series AS Bond certificate will be issued for each maturity of Series AS Bonds in the aggregate principal amount of such maturity, and will be deposited with DTC. If, however, the aggregate principal amount of any maturity exceeds \$500 million, one certificate will be issued with respect to each \$500 million of principal amount, and an additional certificate will be issued with respect to any remaining principal amount of such maturity.

DTC is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Series AS Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series AS Bonds on DTC’s records. The ownership interest of each actual purchaser of Series AS Bonds (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series AS Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Series AS Bonds, except in the event that use of the book-entry system for the Series AS Bonds is discontinued.

To facilitate subsequent transfers, all Series AS Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Series AS Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series AS Bonds; DTC’s

records reflect only the identity of the Direct Participants to whose accounts such Series AS Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Series AS Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series AS Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Series AS Bond documents. For example, Beneficial Owners of Series AS Bonds may wish to ascertain that the nominee holding the Series AS Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, in the alternative Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Series AS Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed. Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Series AS Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Series AS Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Series AS Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Department or the State Treasurer, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, its nominee, the Department or the State Treasurer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Department or the State Treasurer, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Series AS Bonds at any time by giving reasonable notice to the Department or the State Treasurer. Under such circumstances, in the event that a successor depository is not obtained, Series AS Bond certificates are required to be printed and delivered.

The Department and the State Treasurer may decide to discontinue use of the system of book-entry only transfers through DTC (or a successor securities depository). In that event, Series AS Bond certificates will be printed and delivered to DTC.

The information preceding this paragraph in this appendix concerning DTC and DTC's book-entry system has been obtained from sources that the Department and the State Treasurer believe to be reliable, but the Department and the State Treasurer take no responsibility for the accuracy thereof.

THE STATE TREASURER, AS LONG AS A BOOK-ENTRY ONLY SYSTEM IS USED FOR THE SERIES AS BONDS, WILL SEND ANY NOTICE OF REDEMPTION OR OTHER NOTICES TO OWNERS ONLY TO DTC. ANY FAILURE OF DTC TO ADVISE ANY PARTICIPANT, OR OF ANY PARTICIPANT TO NOTIFY ANY BENEFICIAL OWNER, OF ANY NOTICE AND ITS CONTENT OR EFFECT WILL NOT AFFECT THE VALIDITY OR SUFFICIENCY OF THE PROCEEDINGS RELATING TO THE REDEMPTION OF THE SERIES AS BONDS CALLED FOR REDEMPTION OR OF ANY OTHER ACTION PREMISED ON SUCH NOTICE.

The Department and the State Treasurer cannot and do not give any assurances that DTC will distribute to Participants, or that Participants or others will distribute to the Beneficial Owners, payments of principal of and interest and premium, if any, on the Bonds paid or any redemption or other notices or that they will do so on a timely basis or will serve and act in the manner described in this Official Statement. Neither the Department nor the State Treasurer is responsible or liable for the failure of DTC or any Direct Participant or Indirect Participant to make any payments or give any notice to a Beneficial Owner with respect to the Series AS Bonds or any error or delay relating thereto.

The foregoing description of the procedures and record keeping with respect to beneficial ownership interests in the Series AS Bonds, payment of principal of and interest and other payments with respect to the Series AS Bonds to Direct Participants, Indirect Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in such Bonds and other related transactions by and between DTC, the Direct Participants, the Indirect Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the Direct Participants, the Indirect Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters but should instead confirm the same with DTC or the Participants, as the case may be.

SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE SERIES AS BONDS, AS NOMINEE OF DTC, REFERENCES IN THIS OFFICIAL STATEMENT TO THE HOLDERS OF SUCH SERIES SHALL MEAN CEDE & CO., AS AFORESAID, AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE SERIES AS BONDS.

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APPENDIX H

LETTERS FROM CERTAIN UNDERWRITERS

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August 20, 2014

Mr. Blake Fowler
Director, Public Finance Division
Office of the Treasurer of the State of California
915 Capitol Mall, Room 216
Sacramento, CA 95814

RE: State of California Department of Water Resources Central Valley Project Water System
Revenue Bonds, Series AS

Dear Mr. Fowler:

Great Pacific Securities (“GPS”), one of the Underwriters of the Bonds, has entered into a negotiated dealer agreement (the “Dealer Agreement”) with SumRidge Partners LLC (“SumRidge”) for the retail distribution of certain securities offerings at the original issue prices. Pursuant to the Dealer Agreement (if applicable to this transaction), SumRidge will purchase Bonds from GPS at the original issue price less a negotiated portion of the selling concession applicable to any Bonds that SumRidge sells.

Great Pacific Securities

CC: Alicia Ramirez

J.P.Morgan

September 8, 2014,

Mr. Blake Fowler
Director, Public Finance Division
Office of the Treasurer of the State of California
915 Capitol Mall, Room 261
Sacramento, CA 95814

RE: California Department of Water Resources CVP Water System Revenue Bonds,
Series AS (the "Bonds")

Dear Mr. Fowler:

J.P. Morgan Securities LLC ("JPMS"), one of the Underwriters of the Bonds, has entered into a negotiated dealer agreement (the "Dealer Agreement") with Charles Schwab & Co., Inc. ("CS&Co.") for the retail distribution of certain securities offerings at the original issue prices. Pursuant to the Dealer Agreement, CS&Co. will purchase Bonds from JPMS at the original issue price less a negotiated portion of the selling concession applicable to any Bonds that CS&Co. sells.

J.P. MORGAN SECURITIES LLC

Cc: Alicia Ramirez
Department of Water Resources

Morgan Stanley

August 28, 2014

Mr. Blake Fowler
Director of Public Finance Division
Office of the Treasurer of the State of California
915 Capitol Mall, Room 110
Sacramento, CA 95814

RE: State of California Department of Water Resources, Central Valley Project Water System Revenue Bonds, Series AS

Dear Mr. Fowler:

Morgan Stanley & Co. LLC is providing the following language for inclusion in the Official Statement.

Morgan Stanley, parent company of Morgan Stanley & Co. LLC, an underwriter of the Bonds, has entered into a retail distribution arrangement with its affiliate Morgan Stanley Smith Barney LLC. As part of the distribution arrangement, Morgan Stanley & Co. LLC may distribute municipal securities to retail investors through the financial advisor network of Morgan Stanley Smith Barney LLC. As part of this arrangement, Morgan Stanley & Co. LLC may compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the Bonds.

Morgan Stanley & Co. LLC

CC: Alicia Ramirez, California Department of Water Resources



PRAGER & CO., LLC

INVESTMENT BANKERS

August 18, 2014

Mr. Blake Fowler
Director
Office of the Treasurer of the State of California
915 Capitol Mall, Room 110
Sacramento, CA 95814

**Re: State of California Department of Water Resources Central Valley
Project Water System Revenue Bonds, Series AS**

Dear Mr. Fowler:

Prager & Co., LLC, Co-Managing Underwriter for the State of California Department of Water Resources Central Valley Project Water System Revenue Bonds, Series AS (“the Bonds”), has entered into a distribution agreement (the “Distribution Agreement”) with HSBC Securities for the retail distribution of certain municipal securities offerings, at the original issue prices. Pursuant to the Distribution Agreement (if applicable for this transaction), Prager & Co., LLC may share a portion of its underwriting compensation with respect to the Bonds, with HSBC Securities.

Sincerely,
PRAGER & CO., LLC

Cc:
Alicia Ramirez
CA Dept. of Water Resources



August 27, 2014

State of California
State Treasurer's Office
Public Finance Division
915 Capitol Mall, Room 110
Sacramento, CA 95814

Attn: Mr. Blake Fowler, Director of Public Finance Division, State Treasurer's Office

Re: Additional Disclosures by Underwriter/Co-Managing Underwriter
Pursuant to MSRB Rule G-17
State of California Department of Water Resources,
Central Valley Project Water System Revenue Bonds, Series AS

Dear Mr. Fowler:

We are writing to provide you, as Director of the Public Finance Division within the State Treasurer's Office (Issuer), with additional disclosures relating to the captioned bond issue ("Bonds"), as required by the Municipal Securities Rulemaking Board ("MSRB") Rule G-17 as set forth in MSRB Notice 2012-25 (May 7, 2012)¹, as a supplement to the letter you have received from Morgan Stanley & Co., Inc. regarding the same matter.

I. Disclosures Concerning the Underwriters' Compensation:

Siebert Brandford Shank & Co., L.L.C., one of the Underwriters of the Bonds, has entered into a separate agreement with Credit Suisse Securities USA LLC for retail distribution of certain municipal securities offerings, at the original issue prices. Pursuant to said agreement, if applicable to the Bonds, Siebert Brandford Shank & Co., L.L.C. will share a portion of its underwriting compensation with respect to the Bonds, with Credit Suisse Securities USA LLC.

We look forward to working with you in connection with the issuance of the Bonds.

Sincerely,

A handwritten signature in blue ink, appearing to read "Lisa Smith", is written over a horizontal line.

Lisa Smith
Siebert Brandford Shank & Co., L.L.C.
523 West Sixth Street, Suite 703
Los Angeles, CA 90014
lsmith@sbsco.com

CC: Gary Watkins, State Treasurer's Office
Melissa F. Warr, Orrick, Herrington & Sutcliffe LLP
Alicia Ramirez, Department of Water Resources

¹ Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities (effective August 2, 2012).



September 18, 2014

Mr. Blake Fowler
Director
Office of the Treasurer - Public Finance Division
915 Capitol Mall, Room 261
Sacramento, CA 95814

RE: The State of California Department of Water Resources Central Valley Project
Water System Revenue Bonds, Series AS (the "Bonds")

Dear Mr. Fowler:

U.S. Bancorp Investments, Inc. is providing the following provision for inclusion in the
Official Statement for the Bonds:

"US Bancorp" is the marketing name of U.S. Bancorp and its subsidiaries, including U.S. Bancorp
Investments, Inc., which is serving as one of the Underwriters for the Bonds.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jonathan Welch".

Jonathan Welch, CFA
Vice President
U.S. Bancorp Investments, Inc.

Cc: Perla Netto-Brown, State of California Department of Water Resources

APPENDIX I

WATER SYSTEM PROJECTS

Water System Projects consist of the portion of certain State Water Project facilities financed or expected to be financed with Bonds. The Water System Projects are described below. In each case, sources other than Bond Proceeds may have been used to pay certain costs of the facility, particularly those costs allocable to purposes other than water conservation and water transportation.

Capital Expenditures for Water System Projects

The following table summarizes the capital costs financed by Bonds for the Water System Projects described below, and sets forth the capital costs expected to be financed for such projects from the issuance of additional Bonds as of September 4, 2014.

**ESTIMATED CAPITAL FINANCING FROM
WATER SYSTEM REVENUE BONDS FOR EXISTING WATER SYSTEM PROJECTS
(in Millions)**

Water System Project	Capital Expenditures Series A through AS	Estimated Future Capital Expenditures ⁽¹⁾	Total Capital Expenditures ⁽⁵⁾
Powerplants:			
Small Hydro Project	\$ 46.6	\$ 0.0	\$ 46.6
Pyramid Hydroelectric Project	74.4	0.0	74.4
Alamo Project	30.4	0.0	30.4
Bottle Rock Facilities ⁽²⁾	80.2	0.0	80.2
South Geysers Project ⁽³⁾	40.9	0.0	40.9
Reid Gardner Project ⁽⁴⁾	176.2	0.0	176.2
East Branch Enlargement – Phase I	453.0	0.0	453.0
Additional East Branch Improvements	124.1	0.0	124.1
East Branch Enlargement – Phase II	0.0	434.5	434.5
Delta Pumping Plant Completion	73.6	0.0	73.6
Suisun Marsh Environmental Facilities	37.2	0.0	37.2
San Bernardino Tunnel Intake Structure	29.3	0.0	29.3
San Luis Rock Quarry	4.5	0.0	4.5
Castle Rock–Lakeville Transmission Line	6.9	0.0	6.9
Midway-Wheeler Ridge Transmission Line	10.1	0.0	10.1
Kern Water Bank	37.0	0.0	37.0
Vista del Lago Visitor Center	9.0	0.0	9.0
North Bay Aqueduct–Phase II	87.1	0.0	87.1
North Bay Aqueduct Improvements – Terminal Tanks	7.4	6.1 ⁽⁶⁾	13.5
North Bay Aqueduct Alternative Intake	0.0	476.5	476.5
Project Monitor and Control System	71.5	0.0	71.5
SWP Communications System Replacement ⁽⁵⁾	18.6	17.4	36.0
Arroyo Pasajero Flood Control Project	4.3	5.4	9.7
Hyatt Pump-Turbine Refurbishment	17.9	4.6 ⁽⁶⁾	22.5
Edmonston Pump Replacement ⁽⁵⁾	20.7	18.4 ⁽⁶⁾	39.1
Delta Facilities Program	126.3	100.0	226.3
Tehachapi East Afterbay ⁽⁵⁾	67.8	14.9	82.7
Perris Dam Remediation ⁽⁵⁾	36.6	199.3	236.0
Facilities Reconstruction and Improvement Project	259.6	103.6	363.3
Project Planning Costs	112.8	36.2	149.0
Coastal Branch – Phase II	491.3	0.0	491.3
East Branch Extension – Phase I	126.0	0.0	126.0
East Branch Extension – Phase I Improvements ⁽⁵⁾	37.0	0.0	37.0
East Branch Extension – Phase II ⁽⁵⁾	211.0	0.0	211.0
South Bay Aqueduct Enlargement and Improvement ⁽⁵⁾	244.1	.2	244.3
Total Water System Projects ⁽⁷⁾	\$3,173.4	\$1,417.1	\$4,590.6

⁽¹⁾ The projections contained in this table have been prepared by the Department’s management for management purposes on the basis of certain assumptions, and consistent with certain requirements of the Water Supply Contracts. The projections are the responsibility of the Department. Macias, Gini & O’Connell LLP (“MGO”) has neither examined nor compiled such projections and, accordingly, MGO does not express an opinion or provide any other form of assurance with respect thereto. The MGO report included in APPENDIX B of this Official Statement relates to the State Water Project’s historical financial information. The MGO report does not extend to the projections set forth above and should not be read to do so. These projections were not prepared with a view toward compliance with the guidelines established by the American Institute of Certified Public Accountants for preparation and presentation of prospective financial information.

⁽²⁾ Sold by the Department in 2001. (See “WATER SYSTEM PROJECTS – Project Descriptions – *Bottle Rock Facilities*.”)

⁽³⁾ Sold by the Department in 2004. (See “WATER SYSTEM PROJECTS – Project Descriptions – *South Geysers Project*.”)

⁽⁴⁾ The Department’s ownership interest terminated in 2013. (See “WATER SYSTEM PROJECTS – Project Descriptions – *Reid Gardner Project*.”)

⁽⁵⁾ The original Bond Anticipation Bonds (“BABs”) for East Branch Extension – Phase I Improvements and East Branch Extension – Phase II exceeded the projected expenditures. \$44.5 million of the proceeds of the Series AE refunding of the BABs was redistributed from East Branch Extension – Phase I Improvements and East Branch Extension – Phase II to Communications System Replacement, Edmonston Pump Replacement, Tehachapi East Afterbay, Perris Dam Remediation, and South Bay Aqueduct Enlargement.

⁽⁶⁾ Projects are completed. Amounts are treated as “Estimated Future Capital Expenditures” pending reallocation.

⁽⁷⁾ Totals may not sum due to rounding.

The Department may issue additional Bonds in amounts substantially greater than the amounts described in this subsection of Appendix I to finance capital costs allocated to existing Water System Projects or to Water System Projects defined by supplemental resolutions to be adopted in the future. (See “SECURITY FOR THE BONDS – Outstanding Bonds: Additional Bonds” and “STATE WATER PROJECT WATER SUPPLY – Long-Term Planning Efforts for the Delta – *Bay Delta Conservation Plan*”.)

Project Descriptions

The following Water System Projects have been completed:

Small Hydro Project. The Small Hydro Project consists of two small hydroelectric powerplants, the three 11 megawatt units of Mojave Siphon Powerplant and the 3 megawatt Thermalito Diversion Dam Powerplant. The Mojave Siphon Powerplant is located at the downstream end of the Mojave Siphon of the California Aqueduct, at Silverwood Lake, ten miles north of the City of San Bernardino. The Thermalito Diversion Dam Powerplant is located at the left abutment of the Thermalito Diversion Dam on the Feather River one mile north of the City of Oroville.

Pyramid Hydroelectric Project. The Pyramid Hydroelectric Project consists of a portion of the first stage of the William E. Warne Powerplant, formerly known as the Pyramid Powerplant, designated by the Department for electric power generation and transmission, and conveyance facilities between the 75 megawatt William E. Warne Powerplant and Quail Lake, including Lower Quail Canal and the first stage of Peace Valley Pipeline. These facilities are on the West Branch of the California Aqueduct in the vicinity of the town of Gorman in Los Angeles County.

Alamo Project. The Alamo Project consists of the portion of the 17 megawatt Unit 1 of the Alamo Powerplant located on the East Branch of the California Aqueduct, approximately one mile below the Tehachapi Afterbay.

Bottle Rock Facilities. The Bottle Rock Facilities are located in Lake County, California, about 70 miles north of San Francisco. The Bottle Rock Facilities consist of a geothermal powerplant with a 55 megawatt turbine-generator unit, associated electrical, mechanical and control facilities, a heat dissipation system, and a 1.1 mile transmission line. The Department suspended operation of and mothballed the powerplant in 1990 because of the lack of an adequate geothermal steam supply and sold the powerplant in 2001 for \$1.8 million.

South Geysers Project. The South Geysers Project is located in Sonoma County, California, about 70 miles north of San Francisco. The South Geysers Project design included a geothermal generating station with a 55 megawatt turbine-generator unit, associated electrical, mechanical and control facilities, a heat dissipation system, and a 1.8-mile transmission line. The Department suspended construction of the South Geysers Project because of the lack of an adequate geothermal steam supply. In 1990, the Department sold the major equipment components for \$5.5 million and in 2004, the Department sold the plant building and the surrounding property for \$755,000.

Reid Gardner Project. The Reid Gardner Power Plant (“RGPP”), located near Moapa, Nevada, is operated by NV Energy (“NVE”) and consists of four coal-powered generators- Units 1 through 4. The Reid Gardner Project consisted of the Department’s ownership interest in Unit 4 of the RGPP. Prior to termination of the Department’s ownership interest in Unit 4 in 2013, capital ownership of Unit 4 was shared between the Department and NVE at 67.8 percent and 32.2 percent, respectively. The Department also had a 29.2 percent share of the RGPP facilities necessary for and common to all four units. The Participation Agreement between the Department and NVE terminated in 2013. In October 2013, NVE paid the Department approximately \$47.6 million for the Department’s share of undepreciated capital

improvement costs of Unit 4 as required after termination of the Participation Agreement. The Department anticipates having a continuing obligation for a yet to be determined share of environmental remediation costs related to past soil and groundwater contamination at the site. (See “POWER OPERATIONS OF THE STATE WATER PROJECT – Reid Gardner Termination and Groundwater Contamination Cleanup.”)

East Branch Enlargement – Phase I. The East Branch of the California Aqueduct transports water from the aqueduct bifurcation downstream of the A. D. Edmonston Pumping Plant located about 10 miles east of the town of Gorman, across the Antelope Valley and the Mojave Desert, through the San Bernardino Mountains and the cities of San Bernardino and Riverside, to Lake Perris located about 14 miles south of Riverside. The existing facilities along the East Branch include 93 miles of canal, 6.7 miles of inverted siphons, Alamo Powerplant Unit 1, Pearblossom Pumping Plant, Silverwood Lake, San Bernardino Tunnel, Devil Canyon Powerplant Units 1 and 2, Santa Ana Valley Pipeline, and Lake Perris. In 1986, Metropolitan Water District of Southern California and many of the other East Branch contractors agreed to have the Department enlarge the East Branch to an ultimate capacity of 3,149 cubic feet per second at the Alamo Powerplant/Cottonwood Chute Bypass and 2,876 cubic feet per second at Pearblossom Pumping Plant. The Department and the Contractors agreed that the enlargement of the East Branch would be done in two phases, each providing approximately half (750 cubic feet per second) of the planned capacity increase based on a 1,500 cubic feet per second enlargement. This work included an increase to the height of the canal lining, additional siphon conduits, additional pumps at the Pearblossom Pumping Plant, portions of Units 2 and 3 at the Mojave Siphon Powerplant, Units 3 and 4 at the Devil Canyon Powerplant. Construction of Phase I was completed in 1996.

Additional East Branch Improvements. Several additional improvements to the East Branch were constructed concurrently with Phase I of the enlargement. The improvements were needed to bring the existing East Branch up to its originally intended design capacity and to improve the reliability of the system. The major improvements include a portion of a four-foot increase in the height of the canal lining between the Alamo Powerplant and the Pearblossom Pumping Plant, and the addition of a spare pump and modification of the forebay at the Pearblossom Pumping Plant. Construction of these additional improvements was completed in 1993.

Delta Pumping Plant Completion. This project includes the Harvey O. Banks Delta Pumping Plant and the John E. Skinner Delta Fish Protective Facility. Originally the pumping plant was designed for 11 units, but only seven were installed initially. In 1986, the Department signed an agreement with DFW to mitigate or offset direct fishery losses caused by State Water Project pumping under which the Department provides funds for projects inside and outside of the Delta. With this agreement in place, the Department has completed the Delta pumping plant by installing an additional four pumps. The fish protective facility was also enlarged to accommodate the increased capacity. Installation of the four units and the enlargement of the fish protective facility was completed in 1992.

Suisun Marsh Environmental Facilities. The Suisun Marsh Environmental Facilities are designed to protect the quality of water in the Suisun Marsh on the west side of the Delta. These facilities are designed to mitigate the effects of the CVP, the State Water Project, and a portion of other upstream diversion projects. The work to construct these facilities was completed in 1988.

San Bernardino Tunnel Intake Structure. A new intake tower was constructed near the southeastern shore of Silverwood Lake to replace the existing tower, which did not meet current seismic standards. Construction was completed in 1997.

San Luis Rock Quarry. The Department and the Bureau have acquired 689 acres of property adjacent to San Luis Dam. The property includes a rock quarry as a source of material for repair and maintenance purposes.

Castle Rock-Lakeville Transmission Line. Jointly owned with the Pacific Gas and Electric Company (“PG&E”) and two other utilities, the 38-mile Castle-Rock-Lakeville 230 kv transmission line provides transmission from the Geysers geothermal area where the Bottle Rock and South Geysers Projects are located. The Department has sold the South Geysers Project and the Bottle Rock Project. Currently, neither project is operational. (See “WATER SYSTEM PROJECTS – Project Descriptions – *South Geysers Project*” and “– *Bottle Rock Facilities.*”)

Midway-Wheeler Ridge Transmission Line. Jointly owned with PG&E, this 608 megawatt, 230 kilovolt transmission line extends 47 miles from Midway Substation to the Wheeler Ridge Substation and serves the Buena Vista, Wind Gap and Wheeler Ridge pumping plants.

Kern Water Bank. The Kern Water Bank was the land acquisition phase of the development of a ground water recharge and extraction facility in Kern County on the alluvial fan of the Kern River. The Department acquired approximately 20,500 acres of land for the Kern Water Bank. Under the Monterey Amendment, the land and related assets of the Kern Fan Element of the Kern Water Bank have been transferred by the Department to Kern County Water Agency, which in turn transferred such land and related assets to a joint powers authority formed by Kern County Water Agency and other local water suppliers. (See “WATER SUPPLY CONTRACT RELATED LITIGATION – Monterey Amendment Litigation” for a description of certain litigation regarding the validity of the Monterey Amendment and the agreement to transfer the land and related assets of the Kern Fan Element of the Kern Water Bank). The Department will continue to charge Contractors under the Water System Revenue Bond amendment the amounts related to the Water System Revenue Bonds issued to finance the Kern Water Bank.

Vista del Lago Visitor Center. The Vista del Lago Visitor Center is located on an overlook above Pyramid Lake along Interstate 5 approximately 60 miles north of Los Angeles. The center includes educational exhibits on the importance of water supply and the development, distribution, conservation and treatment of water.

North Bay Aqueduct – Phase II. The North Bay Aqueduct – Phase II project completed the construction of the 27 mile North Bay Aqueduct from the Delta to Napa and Solano Counties at the northern edge of the San Francisco Bay. The project consists of 23 miles of pipeline and two pumping plants between Barker Slough on the Delta and the existing Phase I facilities at Cordelia. The project became operational in 1988.

North Bay Aqueduct Improvements – Terminal Tanks. The 7.2 million gallon Napa Turnout Reservoir was constructed by the Department in 1968 to deliver raw water to the Jamieson Canyon Water Treatment Plant and also served the American Canyon Water Treatment Plant. The Department replaced the then existing tank with two new five million gallon tanks in 2010.

Project Monitor and Control System. In July 1990, the Department installed a fiber optics communication system. This system replaced the Department’s obsolete copper wire system. This system reduced costs and increased the reliability, efficiency and capacity of the communication system. A major element of the fiber optics system was the installation of a fiber optics cable adjacent to the California Aqueduct for both commercial and State Water Project use. In 1994, the Department upgraded the backup computer for the Project Operations Control Center. The Department relocated the Control Center in 1995. In 1997, the Department installed additional electronic control, instrumentation and communication equipment.

Hyatt Pump-Turbine Refurbishment. The Hyatt Powerplant is located on the Feather River near the town of Oroville, in Butte County, California. The Powerplant is located within Oroville Dam. It is an underground facility with three reversible pump-turbine units and three turbine units. This refurbishment work improved unit availability and reliability, and increased efficiencies to the highest

extent possible while reducing potential environmental concerns. The major refurbishment work was completed in September 2007 and consisted of replacing the runners, wicket gates, bushings, shaft sleeves, guide bearings, and refurbishing water passages.

Edmonston Pump Replacement. The A.D. Edmonston Pumping Plant has 14 pump units used to pump California Aqueduct water over the Tehachapi Mountains into Southern California. The plant was designed with the capacity to convey 2.5 million acre-feet of Annual Table A Amounts (defined below) to Southern California. In recent years, the plant has been pumping near its maximum capacity; therefore, the units' reliability and availability have become extremely critical to the objectives of the State Water Project. The main objectives of the replacement project are to increase pump reliability, availability, and efficiency while reducing maintenance needs. In August 2001, the design was started to replace the four defective pumps. The first pump was completed in June 2007. The installation and testing of the remaining three pumps was completed in 2012.

Coastal Branch – Phase II. The Coastal Branch – Phase II consists of approximately 100 miles of pipeline between the existing Phase I terminus in Kern County near Devil's Den and a terminus located approximately 3.2 miles south of the town of Casmalia, California, on Vandenberg Air Force Base, and includes three pumping plants and related facilities and three water storage tanks. Construction was completed in 1997. This Water System Project is currently operated and maintained for the Department by the Central Coast Water Authority.

East Branch Extension – Phase I. The East Branch Extension facilities are being constructed in two phases. Phase I consists of new pipelines, three pump stations, a reservoir, and other appurtenant facilities between the existing Foothill Feeder downstream of Devil Canyon Powerplant and the terminus at the Noble Creek Spreading Grounds near the City of Beaumont in Riverside County. The new facilities join existing conveyance facilities constructed by the San Bernardino Valley Municipal Water District and allow the San Gorgonio Pass Water Agency to receive deliveries of State Water Project water. Construction of Phase I facilities was completed in 2003.

Reserve pump units were also added to Greenspot, Crafton Hills and Cherry Valley pump stations to provide increased pumping reliability. The preliminary work for installation of these units began in 2005 and the installation was completed in June 2008.

South Bay Aqueduct Rehabilitation. The South Bay Aqueduct was constructed in the early 1960's. After nearly 30 years of operation, it was in need of numerous repairs and rehabilitation work. It was also necessary to make improvements to the original system to accommodate environmental and operational requirements. The repairs consisted of work items such as replacement of old, deteriorating valves, repairs to pipe linings at numerous locations, complete replacement of the lining of the two steel discharge lines at South Bay Pumping Plant, and repairs to access structures that had been flooded numerous times due to their proximity to existing drainages. The improvements included adding a guard valve at all blow off structures (to allow for future valve repairs/replacements without dewatering the pipeline), adding a second air valve at all high points in the pipelines, constructing access structures at numerous locations where access manholes were buried (prior to environmental considerations related to access), and raising the tops of access structures to prevent future overtopping during high flows in drainages. The project was completed in 2004.

The following Water System Projects have not yet been completed:

East Branch Extension – Phase I Improvements. The East Branch Extension – Phase I Improvements project includes the enlargement of the Crafton Hills Reservoir and construction of the Yucaipa Connector Pipeline. The existing reservoir will be enlarged from 85 acre-feet to approximately 220 acre-feet to provide operational flexibility, system reliability, and a reduction in energy impacts and

costs. Enlargement of the reservoir will allow the Department to fill the reservoir during off-peak periods of the day. Construction of the connector pipeline will allow continued deliveries of water in the East Branch Extension while the reservoir is being enlarged and during future outages of the reservoir. Construction of the pipeline and reservoir began in 2010 and is scheduled to be completed in 2014.

East Branch Enlargement – Phase II. The Phase II enlargement, which will increase the capacity of Pearblossom Pumping Plant from 2010 cfs to 2876 cfs, has been indefinitely suspended at the request of the related Water Contractors. The Phase II enlargement consists of canal embankment and concrete lining; constructing additional siphon barrels; adding bays to check structures; adding two pump/motor units and a discharge line at Pearblossom Pumping Plant; raising overcrossing structures such as bridges, pipelines, and overchutes and extending underdrains.

North Bay Aqueduct Alternate Intake Project. The North Bay Aqueduct Alternate Intake Project will include the construction of a new point of diversion along the Sacramento River or its tributaries, a new pumping plant, an inline storage tank, and up to 30 miles of underground pipeline that will connect to the existing North Bay Aqueduct. The estimated capacity of the new facilities is 240 cfs. The purpose for this project is to enhance the quality, reliability and quantity of water deliveries to State Water Project Contractors while reducing impacts to endangered aquatic species. Solano County Water Agency and Napa County Flood Control and Water Conservation District receive water from the North Bay Aqueduct.

Phase I of this project included work by the Department and environmental consultants to develop required State and federal environmental documentation, acquire temporary entry permits and conduct environmental surveys leading to a Notice of Determination (“NOD”) and Record of Decision (“ROD”), to acquire project environmental permits. Work on Phase I is scheduled to be completed in 2015. Phase II of this project is expected to begin once the NOD and ROD are filed and includes acquisition of the necessary land and right of way, the design and construction of this project. Phase II is expected to be completed by December 2021.

SWP Communications System Replacement. In 2004, the Department began replacing the existing communications system for the State Water Project. The new communications system equipment will be installed at the various area control centers, plants, and check structures along the aqueduct and at other various operation, administration and headquarters facilities. Leased back-up facilities will also be upgraded. This project is anticipated to be completed in 2016.

Arroyo Pasajero Flood Control Project. The Arroyo Pasajero Flood Control Project consists of facilities and measures designed to protect the California Aqueduct from flood waters and sediment carried by the Arroyo Pasajero Creek. This project, which is located near the town of Coalinga in Fresno County, California, is expected to be completed in 2016.

Delta Facilities Program. The Delta Facilities Program consists of projects and measures in the Sacramento-San Joaquin Delta area, and in the vicinity of rivers and tributaries to rivers that flow into the Sacramento-San Joaquin Delta, that are designed to (1) increase water supply by increasing the efficiency of water transfer through the Delta, (2) improve water quality, and (3) reduce or mitigate for fish losses caused by pumping. The projects and measures include dredging, channel improvements, flow control structures, seismic studies and environmental mitigation measures.

Tehachapi East Afterbay. The Tehachapi East Afterbay Project (“TEA”) provides additional afterbay storage for the Valley String Pumping Plants (Buena Vista, Teerink, Chrisman, Edmonston). The previous Tehachapi Afterbay (Pool 42) consisted of the canal section from Porter Tunnel, which bifurcates to the West Branch to Oso Pumping Plant and to the East Branch to Alamo Powerplant and Cottonwood Chutes. The TEA located adjacent to the existing Tehachapi Afterbay, provides storage accessible to both the East Branch and to a lesser extent, the West Branch. The additional storage

provided by the TEA reduces power costs by shifting on-peak power consumption to off-peak, increasing ancillary services capability, and providing other benefits of increased operational flexibility. Operation of the TEA began in 2006 and construction was completed in 2007. The original Antelope Valley – East Kern Water Agency turnout was removed during construction and the replacement turnout is expected to be completed in 2014. The construction of the TEA required a Habitat Conservation Plan to be completed as part of the integration. Completion of the mitigation components is anticipated in 2016.

Perris Dam Remediation Program. Perris Dam Remediation Program contains three main project components: dam foundation remediation, outlet tower retrofit/replacement, and an emergency release conveyance facility. Each project component requires examining numerous operational and remedial alternatives, cost analyses, scheduling, cost estimating, selecting the preferred alternative, required environmental permitting and CEQA documentation, preliminary to the final design, construction, and program closeout. This program is required due to a 2005 Department study that concluded that roughly 2,300-feet of the left reach of Perris Dam’s foundation was potentially liquefiable when subjected to a maximum credible earthquake. In late 2005, the Department implemented a reservoir restriction lowering the water level in the reservoir by about 25 feet which reduced the amount of water stored in the reservoir to about 75,000 acre-feet. This restriction will remain in place as the Department evaluates alternatives for repair of the dam. A subsequent 2006 Department study concluded that the latest seismic loading would also potentially subject the outlet tower to shear failure. Lastly, the construction of thousands of new homes immediately downstream of the Perris Dam requires facility improvements to channel an emergency reservoir release to the Perris drain in the event of a potential catastrophic dam failure. In December 2006, the Department completed a study identifying various repair options, began additional geologic exploration along the base of Perris Dam and started preliminary design. The Department’s preferred alternative is to repair the dam to restore the reservoir to its historical level. Water stored in Lake Perris is used primarily by Metropolitan. Accordingly, Metropolitan is the majority contributor toward the cost of repair or replacement of Perris Dam under its State Water Contract. The Department released its draft EIR in January 2010 and final EIR in September 2011. This dam remediation project is currently anticipated to be completed by the end of 2016. In December 2011, an individual filed a lawsuit against the Department challenging the Department’s compliance with CEQA, including the adequacy of the EIR for the remediation program. This lawsuit was determined in the Department’s favor at the end of 2013; however, the plaintiffs subsequently appealed that ruling. The project is moving forward as planned. The Perris Dam Remediation Program as a whole is anticipated to be completed in 2019.

Facilities Reconstruction and Improvement Project. The Facilities Reconstruction and Improvement Project consists of reconstructions, additions and betterments to water conservation or transportation facilities existing as of January 1, 1987, and to all other facilities described in the Water System Revenue Bond Amendment of the Water Supply Contracts. (See “THE WATER SUPPLY CONTRACTS – Amendments Providing Certain Revenues to Pay Water System Revenue Bonds.”) This includes costs of rebuilding the Thermalito Powerplant. (See “POWER OPERATIONS OF THE STATE WATER PROJECT – Thermalito Powerplant Fire.”)

Project Planning Costs. The Department will be reimbursed for the costs of study or planning of potential Water System Projects. Among the facilities that have been or may be studied are the Coastal Branch of the California Aqueduct; the Arroyo Pasajero Flood Control Project; the Delta Facilities Program; and additional conservation facilities. When the Department determines the actual facility to be acquired and constructed in any given case and that such facility will be financed with Bonds, such facility is designated as a Water System Project.

East Branch Extension – Phase II. Current East Branch Extension Phase I pumping capacity is limited to less than one-half of its total pumping capacity due to the size of the San Bernardino Valley Municipal Water District pipeline. East Branch Extension Phase II will allow 100 percent pumping

capacity and will consist of approximately six miles of a new Mentone pipeline, a new Citrus pump station, a new Citrus Reservoir, an enlargement of the Crafton Hills Pump Station, and an additional pump unit for the Cherry Valley Pump Station. East Branch Extension Phase II reconnaissance level planning began in 2002. Work on the EIR and preliminary design started in 2006, final design began in 2008 and construction began in 2012. Completion of the Phase II facilities is anticipated in 2016.

South Bay Aqueduct Enlargement and Improvement. The South Bay Aqueduct Enlargement will provide the additional capacity required to meet projected increases in water demand in the service area of Alameda County Flood Control and Water Conservation District, Zone 7. The South Bay Aqueduct Improvement will increase the existing capacity to provide the original design capacity of the South Bay Aqueduct. The South Bay Aqueduct Enlargement and Improvement work is being incorporated into a combined project to minimize overall costs and impacts. Major features include enlargement of the South Bay Pumping Plant; construction of a third discharge line and surge tank; construction of the 500 acre-foot Dyer Reservoir; seismic improvements to surge tanks 1 and 2, and modifications to the canal. Construction on the pumping plant and the discharge line began August 2006 and in 2007, respectively. Construction of Dyer Reservoir, the canal modifications and a 69 kv transmission line from Banks Pumping Plant to South Bay Pumping Plant began in 2010. Overall project work is scheduled to be completed in 2014.

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State Water Project Facilities

PUMPING PLANTS

Name	Number of Units	Normal Static Head (feet) (a)	Total Flow at Design Head (cfs)	Total Motor Rating (hp)
Hyatt	3	465-694	5,610	519,000
Thermalito	3	85-102	9,120	120,000
North Bay Aqueduct				
Barker Slough	9	95-120	228	4,800
Cordelia	11	110-376	138	
South Bay Aqueduct				
South Bay	9	543-563	510	27,750
Del Valle	4	0-38	120	1,000
California Aqueduct				
Banks	11	236-252	10,670	333,000
Gianelli (SWP SHARE)	8	99-327	11,000	504,000
Dos Amigos (SWP SHARE)	6	107-125	15,450	240,000
Buena Vista	10 (b)	205	5,405	144,500
Teerink	9 (b)	233	5,445	150,000
Chrisman	9 (b)	518	4,995	330,000
Edmonston	14 (b)	1,926	4,480	1,120,000
Pearblossom	9	540	2,575	203,200
West Branch				
Oso	8	231	3,252	93,800
Coastal Branch				
Las Perillas	6	55	461	4,050
Badger Hill	6	151	454	11,750
Devil's Den	6 (b)	521	134	10,500
Bluestone	6 (b)	484	134	10,500
Polonio Pass	6 (b)	533	134	10,500
East Branch Extension				
Greenspot	4	382	70	3,900
Crafton Hills	3	613	60	4,000
Cherry Valley	2	75	32	300

(a) Amount is for plant in pumping mode.
(b) Includes spare unit.

POWERPLANTS

Name	Number of Units	Normal Static Head (feet) (a)	Total Flow at Design Head (cfs)	Net Dependable Capacity (MW)	Nameplate Capacity (MW)
Hyatt	6	435-694	16,950	645	645
Thermalito	4	85-102	17,400	114	114
Thermalito Diversion Dam	1	63-77	615	3	3
Gianelli					
Total	8	99-327	16,960	363	424
SWP Share				190	222
Alamo	1	115-141	1,740	15	17
Mojave Siphon	3	81-136	2,880	29	30
Devil Canyon	4	1,406	2,940	235	276
Warne	2	719-739	1,564	67	74
Castaic					
Total	7	900-1,050	20,820	1,128	1,254
SWP Share				192	214

(a) Amount is for plant in generating mode.

PRIMARY RESERVOIRS and DAMS

Name	Reservoirs (a)		Dams	
	Capacity (acre-feet)	Surface Area (acres)	Structural Height (feet)	Crest Length (feet)
Antelope Lake	22,564	930	120	1,320
Frenchman Lake	55,475	1,580	139	720
Lake Davis/ Grizzly Valley Dam	84,371	4,030	132	800
Lake Oroville	3,537,577	15,805	770	6,920
Thermalito Forebay	11,768	630	91	15,900
Thermalito Afterbay	57,042	4,300	39	42,000
Thermalito Diversion Pool	13,353	320	143	1,300
Clifton Court Forebay	31,258	2,180	30	36,500
Bethany	5,070	180	121	3,940
Lake Del Valle	77,100	1,060	235	880
San Luis Reservoir/Sisk Dam SWP Storage (b)	2,027,835	12,520	385	18,600
SWP Storage (c)	1,062,183			
O'Neill Forebay SWP Storage (c)	56,433	2,700	88	14,350
SWP Storage (c)	29,500			
Los Banos	34,562	620	167	1,370
Little Panoche	5,580	190	152	1,440
Quail Lake (d)	7,580	290		
Pyramid Lake	171,200	1,300	400	1,090
Elderberry Forebay	32,480	500	200	1,990
Castaic Lake	323,700	2,240	425	4,900
Silverwood Lake/ Cedar Springs Dam	74,970	995	249	2,230
Lake Perris	131,450	2,320	128	11,600
Crafton Hills (e)			95	500

(a) Reservoir data represent design elevation, generally spillway crest level. In most cases, maximum operational levels are set 1 or 2 feet lower.
(b) SWP share of total storage of 2,027,835 acre-feet.
(c) SWP share of total storage of 56,433 acre-feet.
(d) Primary reservoir only.
(e) Primary dam only.

AQUEDUCTS

Name	Length (miles)
Grizzly Valley Pipeline	6.0
Thermalito Power Canal and Tail Channel	3.4
North Bay Aqueduct	27.6
South Bay Aqueduct	44.6
Subtotal	81.6
Edmund G. Brown California Aqueduct (main line):	
Delta to O'Neill Forebay	66.7
O'Neill Forebay to Kettleman City (joint use)	105.7
Kettleman City to Edmonston Pumping Plant	121.0
Edmonston Pumping Plant to Tehachapi Afterbay	10.0
Tehachapi Afterbay to Lake Perris	140.0
Subtotal, main line	443.4
California Aqueduct (branches):	
West Branch	31.9
Coastal Branch	115.5
East Branch Extension	
Devil Canyon Powerplant to Greenspot	16.2
Greenspot to Noble Creek Terminus	16.4
Subtotal, branches	180.0
Total	705.0

State Water Project Facilities

WATER SUPPLY CONTRACTORS

- Plumas Co. Flood Control & Water Conservation District
- County of Butte
- City of Yuba City
- Napa Co. Flood Control & Water Conservation District
- Solano Co. Water Agency
- Alameda Co. Flood Control & Water Conservation District Zone 7
- Alameda Co. Water District
- Santa Clara Valley Water District
- Oak Flat Water District
- Dudley Ridge Water District
- County of Kings
- Empire West Side Irrigation District
- Tulare Lake Basin Water Storage District
- San Luis Obispo Co. Flood Control & Water Conservation District
- Kern Co. Water Agency
- Santa Barbara Co. Flood Control & Water Conservation District
- Ventura Co. Watershed Protection District
- Castaic Lake Water Agency
- Antelope Valley - East Kern Water Agency
- Palmdale Water District
- Little Rock Creek Irrigation District
- Mojave Water Agency
- Crestline - Lake Arrowhead Water Agency
- San Bernardino Valley Municipal Water District
- San Gabriel Valley Municipal Water District
- The Metropolitan Water District of Southern California
- San Geronio Pass Water Agency
- Desert Water Agency
- Coachella Valley Water District



indicates SWP/CVP joint use

